# Short Subjects

Minnesota House of Representatives, House Research

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Nina Manzi and Joel Michael

Updated: January 2008

# Capital Gains Taxation: Federal and State

***What is capital gains income?***

When a taxpayer sells a capital asset, such as stock holdings, a home, or longer-lived business assets, the difference between the amount realized on the sale and the taxpayer's basis is either a capital gain or a loss. The taxpayer's "basis" is usually what the taxpayer paid for and invested in the asset, less any depreciation deductions claimed for business assets. Special rules apply to assets received as a gift or through inheritance.

***What are short-term and long-term gains and losses?***

The gain or loss on an asset held for more than one year is considered "long term." If the taxpayer disposes of an asset after holding it for a year or less, the gain or loss is "short term."

***How does the federal government tax capital gains income?***

The maximum federal income tax rate for most net long-term capital gains income is 15 percent in tax year 2008. There is no tax on capital gains income in 2008 through 2010 for taxpayers in the 10 percent or 15 percent bracket for ordinary income—in tax year 2008 the 0-percent rate applies for married joint filers with taxable income under $65,100. The amount of net capital gains income that qualifies for the maximum 15- or 0-percent rate is the long-term capital gain after subtracting both long-term capital losses and net short-term capital losses (i.e., in excess of short-term capital gains). Short-term capital gains do not qualify for the preferential federal rates but are taxed as ordinary income.

***Are there higher rates for certain kinds of income?***

Three exceptions to the maximum 15- and 0-percent federal rates apply:

- The portion of the gain from qualified small business stock is subject to a maximum 28-percent rate (up to 50 percent of the gain on the sale of this stock may be excluded from taxable income entirely)
- The net capital gain from selling collectibles (such as coins or art) is subject to a maximum 28-percent rate
- The part of any net capital gain on property for which the taxpayer claimed "additional depreciation" (Section 1250 real property) is taxed at a maximum 25-percent rate

***Is there special tax treatment for gains realized through the sale of the taxpayer's home?***

Yes. Taxpayers who meet "use" and "ownership" tests may exclude up to $250,000 of gain on the sale of the home (up to $500,000 for married joint taxpayers). Under the "use" test, the taxpayer must have used the home as his or her principal residence for two of the five years preceding the sale. Under the "ownership" test, the taxpayer must have owned the home for at least two years. There is no limit to the number of times a taxpayer may claim this exclusion.

***Can capital losses reduce ordinary income?***

Yes, up to $3,000 per year of capital losses can be deducted from ordinary income. Losses over $3,000 are carried forward to future tax years. Losses on personal use items, such as a home or car, are not deductible.

***How does Minnesota tax capital gains income?***

Minnesota includes all net capital gains income in taxable income and subjects it to the same tax rates as apply to other kinds of income: 5.35, 7.05, and 7.85 percent. Minnesota does recognize the federal exclusion of up to $250,000 of gain realized on the sale of the taxpayer's home ($500,000 for married joint taxpayers) and the exclusion of part of the gain on qualified small business stock.

***How do other states that impose an individual income tax treat capital gains income?***

- 22 states, including Minnesota, do not provide preferential treatment for capital gains income
- Six states (Arkansas, New Mexico, North Dakota, South Carolina, Vermont, and Wisconsin) exclude a portion of capital gains income
- Four states exclude all or part of the gain on property located in the state (Colorado, Idaho, Iowa, and Oklahoma); the exclusion applies to gains on sale of stocks of in-state companies in Colorado and Oklahoma
- Six states exclude all or part of the gain for certain investments, such as in new businesses or low-income housing (Arkansas, Missouri, Montana, Nebraska, New York, and Utah)
- Three states exclude gains on some or all state and local bonds (Connecticut, Kentucky, and Ohio)
- Two states (Massachusetts and Rhode Island) apply lower rates to capital gains income, depending on how long the taxpayer has held the asset
- One state excludes gains resulting from eminent domain (Kentucky)

***What are the income levels and filing types of people who have capital gains income?***

In tax year 2005, about 25 percent of all returns filed by Minnesota residents reported some capital gains income. Married taxpayers filing joint returns received 78 percent of capital gain income. Filers with incomes over $100,000 received over 88 percent of capital income; the table shows the distribution by income range in 2005.

| Federal adjusted gross income | $ of capital gains reported (millions) | % of all gains reported | % of income consisting of gains | Average gains per return |
|---|---|---|---|---|
| | | | returns with capital gains | |
| Less than $50,000 | $403 | 4.7% | 1.3% | $1,680 |
| $50,000 to $99,999 | $595 | 6.9% | 1.4% | $3,285 |
| $100,000 to $500,000 | $2,351 | 27.5% | 5.7% | $16,575 |
| Over $500,000 | $5,213 | 60.9% | 27.7% | $425,579 |
| All incomes | $8,562 | 100.0% | 6.5% | $14,884 |

***What are the ages of taxpayers who have capital gains income?***

Almost half of taxpayers aged 65 and older reported some capital gains income in tax year 2005. The table shows the percent of gains by age of taxpayer.

| Taxpayer age | $ of capital gains reported (millions) | % of all gains reported | % of income consisting of gains | Average gains per return |
|---|---|---|---|---|
| | | | returns with capital gains | |
| Less than 25 | $110 | 1.3% | 1.9% | $2,171 |
| 25 to 39 | $665 | 7.8% | 2.2% | $8,352 |
| 40 to 64 | $5,329 | 62.2% | 6.8% | $18,434 |
| 65 or older | $2,458 | 28.7% | 14.1% | $15,773 |
| All ages | $8,562 | 100.0% | 6.5% | $14,884 |

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

**Joel Michael**

**Updated: January 2008**

# 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 or municipality (city or county) 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?***

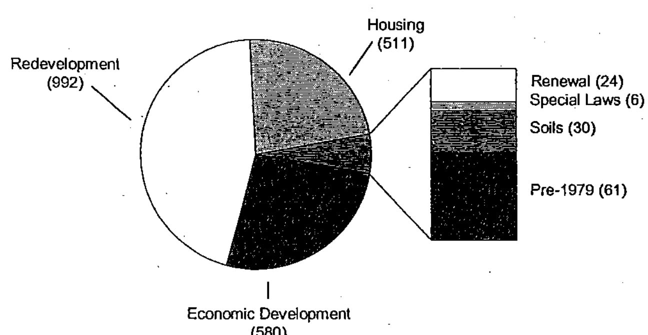
Minnesota allows several different types of TIF districts. The legal restrictions on how long increments may be collected, the sites that qualify, and the purposes for which increments may be used vary with the type of district.

| 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 2005***

According to the 2006 report of the Office of State Auditor, there were 2,204 active TIF districts in 2005. The graph shows the relative shares by type of district.

**TIF Districts by Type in 2005**
(2,204 districts)




Source: 2006 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.

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**HOUSE RESEARCH** | **Short Subjects**

**Joel Michael**

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# 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 million 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 if they structure transfers to trusts appropriately.

**Tax rates.** The tax rates range from 0.8 percent to 16 percent. The top rate applies to the amount of the taxable estate over $10,040,000. These rates are calculated on estate values over $40,000, not the $1 million exemption. Because no tax is due on estates of less than $1 million and because the tax cannot exceed the tax under pre-2001 federal law, some estates experience "marginal" rates of up to 41 percent. Average or effective rates can never exceed 16 percent, though.

***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 (November 2007 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 2003-2007 (millions) | |
|---|---|
| 2003 | $127.7 |
| 2004 | $90.1 |
| 2005 | $72.7 |
| 2006 | $215.9 |
| 2007 | $110.9 |

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 without estate or inheritance 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; many states have taken no action to impose estate taxes or have repealed their taxes.) If these individuals change their domiciles, they would also avoid the state income tax, since some of these states (for example, Florida, Nevada, and Texas) 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 Estate and Inheritance Taxes After the 2001 Federal Estate Tax Changes*, January 2008.

Joel Michael

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# TIF: Deficit Reduction Provisions

*Property tax reforms in the late 1990s and 2001 reduced TIF revenues significantly*

Property tax changes enacted by the legislature in 1997, 1998, and 2001 reduced the revenues of many tax increment financing (TIF) districts. This occurred because the changes generally reduced property taxes, and tax increments are ultimately property taxes. The effects on TIF districts were larger than on overall property taxes because:

- Each of the "reforms" were focused on reducing property taxes on commercial-industrial (C-I) and apartment properties, the main types of property in TIF districts; and
- The 2001 reform converted a portion of the general education tax, a tax imposed by school districts that contributed to TIF revenues, to a state-imposed tax on C-I properties, which did not contribute to TIF revenues.

The 2001 property tax changes reduced TIF revenues (between taxes payable in 2001 and in 2002) by approximately 30 percent. TIF revenues have increased significantly since 2002, but in 2007 are still down 12 percent from 2001 (or about $41 million). Some of these revenues are attributable to new districts and are not available to pay obligations of old districts.

*Reduced TIF revenues may impair the ability to pay TIF obligations or create deficits*

These reductions in increments may cause "deficits" or the inability to pay debt with the pledged increments. Revenues of TIF districts are commonly pledged to pay debt; TIF authorities often borrow money to pay upfront development costs, such as a land acquisition and public improvements in the district. This debt can be a general obligation of the local government (i.e., supported also by a pledge to levy enough property taxes to pay the bonds, if necessary), a revenue bond, or a developer obligation (often called a "pay-as-you-go" note). The consequences of a deficit vary with the type of TIF obligation:

- For general obligations, the local government must make up the deficit by levying property taxes.
- For revenue bonds, the bondholders may suffer the loss, unless the authority or others have pledged other revenues. The authority or city may feel compelled to pay revenue bonds to maintain its creditworthiness.
- Developer obligations are usually limited to the amount of increment; thus, the developer or the holder of the obligations will suffer the loss.

*The legislature has enacted a variety of tools to help reduce or eliminate deficits*

The legislature has enacted several mechanisms to help local governments offset deficits caused by property tax reforms. All of these mechanisms use one of three basic approaches:

- **Pooling**: Allowing more flexibility to take increments from one of a city's TIF districts to pay obligations of another district
- **Increasing increments revenues**: Allowing methods by which the authority or city could increase the total amount of increment revenues collected

- **State grants**: Appropriating state money to pay grants to offset deficits

***Pooling allows surplus increments from one district to offset a deficit in another district***

The TIF law imposes legal restrictions (commonly called "pooling" limits) on using increments from one district to pay for activities outside of that district. Thus, extra increments from one district frequently cannot be used to pay the debt of another district. To give authorities and cities more flexibility to deal with deficits caused by property tax changes, the legislature allowed cities to use increments from one district to pay obligations of another district, if the shortfall was caused by property tax reform. Use of pooling originally was a prerequisite to using the other deficit reduction techniques. That is no longer required, except as a condition of using the authority to extend a district's duration limit.

***Various mechanisms can increase increments to offset deficits***

The second approach uses mechanisms that increase a TIF district's increments. These mechanisms all rely, directly or indirectly, on property tax increases to help pay the deficits. These techniques either convert existing property tax revenues of the city, county, or school into increments or capture tax base that would have paid regular taxes. Three basic mechanisms have been authorized:

- **"Unfreezing" the original tax capacity rate**: This is the local tax rate in effect when the district was certified. If local tax rates have risen since this certification, unfreezing the rate will increase the amount of increment.
- **Changing fiscal disparities options**: For TIF districts in the metropolitan area or the taconite tax relief area, the city can elect to have the fiscal disparities contribution paid by property taxpayers in the city, county, and school, rather than using the district's increment to do so.
- **Extending the duration of the district**: The city can elect to extend the duration limit for the TIF district under a formula based on the percentage drop in the district taxes caused by tax reform. The maximum extension is four years, although the commissioner of revenue can authorize an additional two years. To use this authority, the city must have fully used all of the other deficit reduction mechanisms.

***The state grant fund was repealed as part of the 2002 budget cuts***

The 1997, 1999, and 2001 legislatures made general fund appropriations to a state grant fund to help offset TIF deficits caused by property tax reform. The table shows the amounts. Two separate funds were established, one in response to the 1997-98 property tax changes, and one for the 2001 changes. Grants were paid out under the first fund, but the remainder of the money in that fund and all of the funding for the 2001 fund was repealed in response to the state's budget deficit in the 2002 legislative session. This means cities must deal with TIF deficits using mechanisms that shift TIF funds from other districts or that increase TIF revenues, as described above.

**TIF Grant Appropriations**

| Session | Amount (millions) |
|---|---|
| 1997 | $2 |
| 1999 | 4 |
| 2001 one-time | 91 |
| 2001 ongoing per year | 38 |

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *TIF Duration Extensions to Offset Deficits*, October 2003.

**Joel Michael**

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# TIF Redevelopment Districts

***TIF is often used to help redevelop real estate in blighted areas***

The classic use of tax increment financing (TIF) is to foster redevelopment of "blighted" areas—i.e., areas with rundown, dilapidated, or obsolete buildings and structures. The increase in property taxes that results from redevelopment (the "increment") is used to help finance redevelopment costs, such as land assembly and removal of blighted structures. In Minnesota, TIF was initially promoted principally for redevelopment. (It has since grown to be used in the state for housing, economic development, and general infrastructure finance.) According to the 2006 Tax Increment Financing Report of the State Auditor, there were more active TIF redevelopment districts (992) than any other type, about 46 percent of all TIF districts (2,204) in 2005.

***What areas can be designated as redevelopment TIF districts?***

Minnesota law allows redevelopment districts to be designated in areas that qualify under one of the following criteria:

- Meet a statutory "blight test"
- Are vacant or underused railyards
- Contain vacant or underused tank farms with a capacity of at least one million gallons
- Are qualified disaster areas

***What areas qualify as "blighted"?***

To qualify under the blight test:

- 70 percent of the area of the district must be occupied by buildings, streets, utilities, or other improvements, and
- More than 50 percent of the buildings must be structurally substandard.

Buildings are substandard if they have sufficient defects or other problems to justify substantial renovation or clearance, in the judgment of the authority. The authority must determine this after conducting an interior inspection of the property, unless the property owner refuses to permit an inspection.

The authority cannot find a building is substandard if it is in compliance with the building code for new buildings or could be brought into compliance for less than 15 percent of the cost of constructing a similar new building. Meeting this 15 percent test, however, does not itself qualify the building as substandard.

***May districts be noncontiguous?***

Yes, TIF districts generally may consist of separate, noncontiguous areas. However, each separate noncontiguous area of a redevelopment district must individually meet one of the qualifying tests as: blighted, a railyard, a tank farm, or a qualified disaster area.

***What are qualified disaster areas?***

To be a qualified disaster area, an area must meet three tests:

- 70 percent of the parcels must be occupied by buildings, streets, utilities, or other improvements
- The area was a declared a disaster under federal or state law within 18 months before creation of the district
- 50 percent or more of the buildings suffered substantial damage as a result of the disaster

For a qualified disaster area district, the original net tax capacity (i.e., the base value used to calculate increments) is the land value. The most recent assessment will generally include the full value of the buildings (i.e., it would not reflect the damage caused by the disaster). Absent a "write-down" of the original value to the land value, reconstruction following a disaster would not generate much or any increment, since it would largely restore the pre-existing value.

***What are permitted uses of increments for redevelopment districts?***

The law requires 90 percent of the increments from a redevelopment district to be spent for blight correction—i.e., to fix the conditions that allowed designation of the district. The statute lists the following as qualifying expenditures:

- Site acquisition of blighted sites or sites requiring pollution clean-up
- Acquisition of an adjacent parcel or parcels to assemble a site large enough to redevelop
- Clean-up of hazardous substances, pollution, or contaminants
- Site preparation, such as clearing the land and installation of utilities, roads, sidewalks
- Providing parking facilities for the site

The law explicitly provides that this is not an exhaustive list. Administrative expenses of the authority that are allocated to these activities also meet the 90 percent test.

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research short subject *Tax Increment Financing*, January 2008.

HOUSE RESEARCH | Short Subjects

Jim Cleary

January 2008

# Veteran's Preference in State and Local Government Employment

***What is veteran's preference?***

The Minnesota Veteran's Preference Act (VPA) grants veterans a limited preference over nonveterans in hiring and promotion for most state and local governmental employment. It also provides local government employees who are veterans some protection against unfair demotions and dismissal.

These preferences and protections are commonly referred to as "veteran's preference" and are codified in Minnesota Statutes sections 43A.11, 197.455, 197.46, 197.48, and 197.481.

***Who is a veteran or a disabled veteran?***

For purposes of veteran's preference, "veteran" is defined in Minnesota Statutes sections 197.447, and "disabled veteran is defined both in Minnesota Statutes sections 43A.11, subdivision 5 (for state civil service), and slightly differently in Minnesota Statutes sections 197.455, subdivision 6 (for political subdivisions). These definitions are rather detailed and should be read directly.

***To which positions does veteran's preference apply?***

Minnesota veteran's preference applies to most positions of employment in state civil service, as well as to most positions within political subdivisions. VPA *does not apply* to employment in the private sector or federal government.

***How does veteran's preference apply to state civil service?***

In state civil service, people who claim veteran's preference and who meet the minimum qualifications for a vacant state government position are listed before qualified nonveteran applicants in the applicant pool for the position. Disabled veterans must be listed ahead of nondisabled veterans.

The state appointing authority may hire anyone in the pool, but if it rejects a person in the finalist pool who has claimed veteran's preference, it must notify the person of the reasons for the rejection. (Minn. Stat. § 43A.11)

In state civil service, veteran's preference applies only to hiring, not to dismissal.

***How does veteran's preference apply to political subdivisions?***

For political subdivisions (including counties, cities, towns, school districts, and any other political subdivisions), nondisabled veterans who have a passing score or rating on an exam can elect to receive a credit of five points (on a 100-point scale). Disabled veterans with passing ratings on an exam can elect to receive a credit of ten points. A disabled veteran can also elect to receive a credit of five points on the person's first promotional exam after securing public employment. (Minn. Stat. § 197.455)

***How does veteran's preference work in dismissal?***

A veteran holding a position of appointment or employment in any political subdivision can be removed from that position only for incompetence or misconduct established in a hearing, with due notice and stated charges in writing.

Exempted from such protection are veterans working as a secretary, teacher, superintendent of schools, chief deputy of any elected official or head of a department, or any person holding a strictly confidential relation to an appointing officer. (Minn. Stat. § 197.46) (Veteran's preference protections in dismissals also do not apply to state civil service, and veteran's preference laws in general do not apply to the University of Minnesota.)

***How are veteran's preference laws enforced?***

A veteran who has been denied veteran's preference rights by the state or any political subdivision of the state may petition the commissioner of veterans affairs for an order directing the agency to grant the relief that the commissioner finds justified. The commissioner is given broad powers of subpoena, as well as access to records, witnesses, and documents. The affected political subdivision must bear all costs incurred by the commissioner for this purpose.

In accordance with various provisions of the Administrative Procedure Act (Minn. Stat. ch. 14), either party may appeal the commissioner's orders to the district court. The commissioner and attorney general may represent the veteran in any appeal following a favorable decision for the veteran. When a party refuses or fails to comply with a final decision of the commissioner, the commissioner may ask the Ramsey County District Court to order the party to comply and award damages. (Minn. Stat. § 197.481)

***Are retired military personnel eligible for veteran's preference?***

Since the post-Vietnam War era, persons who were eligible for a military pension based entirely on years of military service were not eligible for veteran's preference in Minnesota. However, that statutory provision was repealed in 2005. Retired military veterans now have the same preference as other veterans in state and local government hiring.

**For more information:** Contact the Minnesota Department of Veterans Affairs at 651-757-1568. For federal veteran's preference laws, contact the local veterans' representative for the U.S. Department of Labor at 651-259-7511.

**Joel Michael**

**Updated: January 2008**

# 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 (effective for decedents dying after December 31, 2004). States now can no longer impose estate taxes that do not increase the total tax burden on estates and heirs. EGTRRA also increased the exemption amounts and reduced tax rates under the federal estate tax.

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 December 2007.

***Twenty-seven states no longer impose estate or inheritance taxes***

For decedents dying in calendar year 2007, 27 states no longer 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, SD, and VA). 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 five more states are set to expire after 2007***

Three states have enacted legislation that repeals their taxes (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. At the November 2006 general election, voters rejected an initiative to repeal the Washington estate tax.

***Six states impose only inheritance taxes***

Six states (IN, IA, KY, NE, 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. Nebraska repealed its estate tax, but retained its county inheritance tax. 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 2007*

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 (current federal exemption: IL, NC, VT, and VA). The other states, like Minnesota, have a $1 million exemption (based on the pre-EGTRRA credit amount). Five states have separate estate taxes with their own exemption amounts and tax rate schedules (CT, KS, OH, OK, 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.

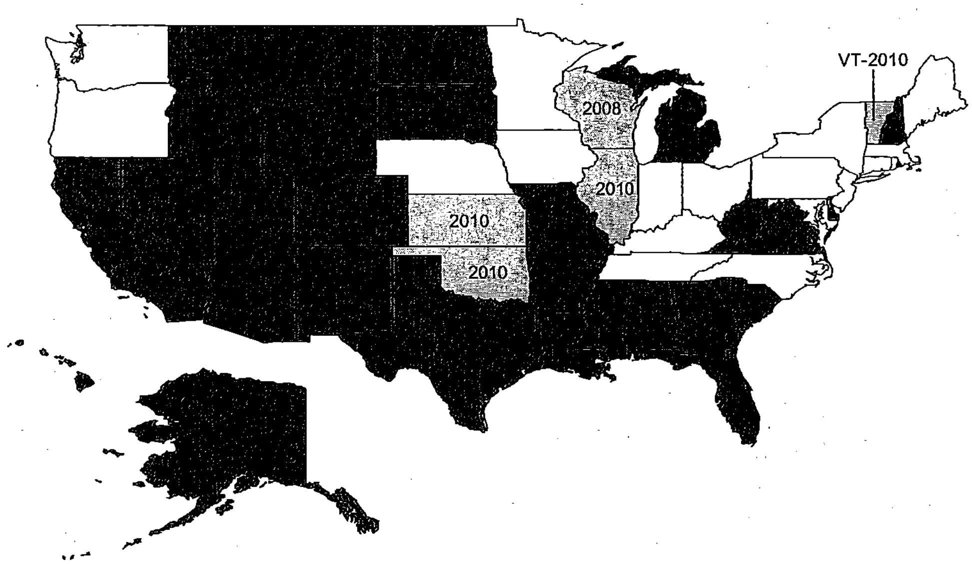
*Two states impose both estate and inheritance taxes*

Maryland and New Jersey have both estate and inheritance taxes. The inheritance taxes have unlimited exemptions for lineal heirs (children, grandchildren, parents, and so forth). 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

**(2007 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.

**Joel Michael** **Updated: January 2008**

# Single Sales Apportionment of Corporate Franchise Tax

***Apportionment is a key feature of state 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 using the Minnesota proportions of the corporation's sales, payroll, and property factors to determine corporate franchise tax.

***Minnesota is phasing in single sales apportionment***

Under legislation enacted in 2005, Minnesota has begun phasing in single sales apportionment under its corporate franchise tax; the phase-in will occur over eight years, starting in tax year 2007. For tax years 2001 through 2006, Minnesota 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 is. A classic example is a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but 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.

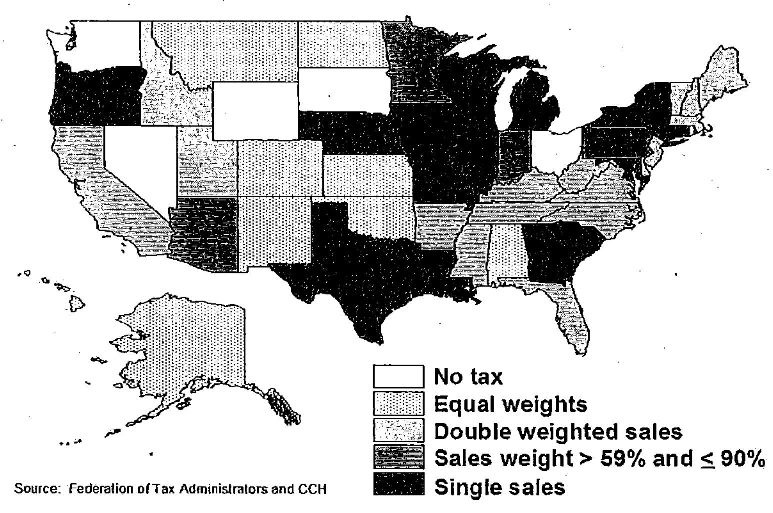
*Cost is about $40 million to $50 million per year*

Phasing in single sales apportionment is reducing corporate franchise tax revenues. Compared with 75 percent sales weighting, the reduction is about $50 million per year (based on a 2005 estimate by the Department of Revenue). Since the phase-in is now reflected in the underlying budget, accelerating the phase-in (e.g., to tax year 2009) would likely have a smaller cost of about $40 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, 14 states will 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, Michigan, Missouri, Nebraska, and Wisconsin. Indiana is scheduled to use single sales in 2011. The map below shows the apportionment formulas for manufacturers as of tax year 2008.

**Apportionment of Corporate Income**
**Applicable to Manufacturers**




**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.

Joel Michael

Updated: January 2008

# 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 FY2007) | 26 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. Effective August 1, 2007, the commissioner set the rate at 26 cents. The previous rate was 26.3 cents.
- 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. 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) *cert. denied* 127 S.Ct. 666 (2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) *cert. denied* 127 S.Ct. 1259 (2007) (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 $223.6 million and from the health impact fee, $225.4 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.

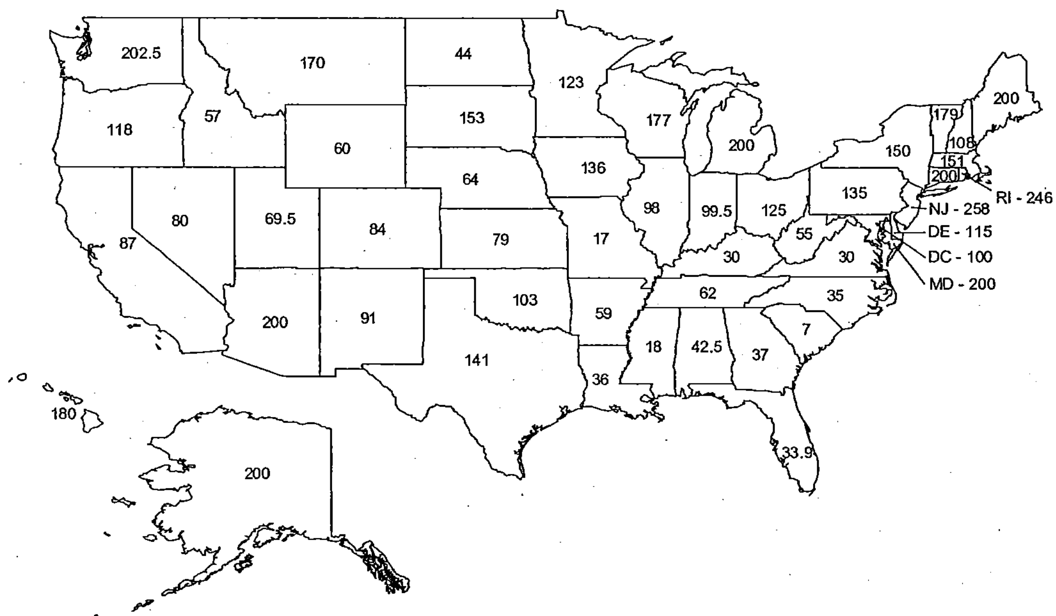
***Neighboring states have higher tax rates***

Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. Taking into account the combined effects of Minnesota's tax and fee ($1.23/pack), three bordering states have higher rates: Wisconsin ($1.77), South Dakota ($1.53), and Iowa ($1.36). North Dakota (44 cents) has a lower rate. 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. Hawaii's tax is scheduled to increase by 20 cents each July 1 from 2007 through 2011.

**State Cigarette Tax Rates***

as of 1/1/2008

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.

Karen Baker Updated: January 2008

# Mortgage and Deed Taxes: An Overview

***What is the mortgage registry and deed tax?***

The mortgage registry tax (MRT) is a tax based upon the amount of debt secured by a mortgage of real property. The tax is imposed on the privilege of recording the mortgage. The deed tax is a transfer tax; it is imposed on the value of real property transferred. While these taxes are independent of each other, they are often thought of as a pair since many property transactions involve both a mortgage and a deed.

***What are the rates?***

The MRT is calculated at the rate of 0.23 percent of total debt secured. The deed tax is calculated at the rate of 0.33 percent of net consideration (i.e., the price paid for the real property). These rates have been in effect since 1987.

***How does it work?***

The following example helps illustrate how each of the taxes is determined for a homebuyer.

**Mortgage Registry Tax**

John and Mary Anderson secure a loan on a home with a purchase price of $150,000. The Andersons make a $20,000 down payment on the home. The principal debt on the home is $130,000. How much mortgage registry tax do the Andersons owe?

Principal debt x 0.23% = MRT liability

$130,000 x 0.23% = $299

The Andersons owe $299 in MRT.

**Deed Tax**

John and Mary Anderson record the deed for their new home. The deed is valued at $150,000. How much deed tax must be paid?

Value of the deed recorded x 0.33% = deed tax liability

$150,000 x 0.33% = $495

$495 must be paid when the deed is recorded.

***Who is responsible for paying the tax?***

In the case of the MRT, the mortgagor (borrower) is liable. In the case of the deed tax, the seller is liable. The lender usually collects both of the taxes at closing, and is responsible for remitting them to the county treasurer when the mortgage and deed are recorded.

The amount of deed tax is usually collected from the seller at the time of closing. However, since the deed tax must be paid in order to record the deed, and since it is in the buyer's best interest to record the deed, the tax could fall on the buyer if the dollars were not collected from the seller.

***Who collects the money?***

County treasurers collect these taxes. They remit 97 percent to the state, which is deposited in the general fund. The county retains the other 3 percent for administrative expenses.

***How much is collected?***

The table below shows the MRT and deed tax generated in the state for the past ten years. The increased collections in MRT in the past four to five years has been due partially to low interest rates, which generated more refinancing and purchases, and the strong economy. The total amounts reflect only the state's 97 percent share.

**MRT and Deed Tax Revenue** (in millions)

| Fiscal Year | Mortgage | Deed | Total | Change Amount (from previous year) | Change Percent (from previous year) |
|---|---|---|---|---|---|
| 1998 | $67.6 | $52.6 | $120.2 | $25.4 | 26.8% |
| 1999 | 89.8 | 63.0 | 152.7 | 32.5 | 27.0 |
| 2000 | 73.4 | 68.8 | 142.2 | -10.5 | -6.9 |
| 2001 | 88.2 | 71.0 | 159.2 | 17.0 | 12.0 |
| 2002 | 145.1 | 86.1 | 231.2 | 72.0 | 45.2 |
| 2003 | 203.4 | 94.3 | 297.7 | 66.5 | 28.8 |
| 2004* | 230.2 | 120.6 | 350.7 | 53.0 | 17.8 |
| 2005* | 162.2 | 124.2 | 286.4 | -64.3 | -18.3 |
| 2006 | 173.6 | 136.4 | 310.0 | 23.6 | 8.2 |
| 2007 | 149.2 | 111.5 | 260.7 | -49.3 | -15.9 |
| 2008 est. | N/A | N/A | 175.3** | -85.4 | -32.8 |
| 2009 est. | N/A | N/A | 163.0** | -12.3 | -7.0 |

* Accelerating the June payment began in fiscal year 2004 and distorts the change amounts and percentages for fiscal years 2004 and 2005.
** Department of Finance November 2007 forecast.

***Where is it collected?***

About two-thirds of the statewide collections for MRT and deed tax come from the seven-county metro area, the remaining one-third from Greater Minnesota. Using 2006 population and the 2007 tax amounts, the statewide average per capita was $50, with a metro county average of $61, and a Greater Minnesota average of $36.

***Are there exemptions from the taxes?***

There are many statutory exemptions from each tax. Minnesota Statutes, section 287.04, contains a list of the exemptions from the MRT. The primary ones are contracts for deed, certain agricultural mortgages, marriage dissolution decrees, and certain low- and moderate-income housing mortgages.

Minnesota Statutes, section 287.22, contains a list of the exemptions from the deed tax. Some of the most common are recording an amendment to the mortgage, a plat, a will, a lease, a sheriff's certificate of sale in a foreclosure sale, and a decree or deed involving a marriage dissolution.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959. Also see the House Research publication *Mortgage and Deed Taxes in Minnesota*, April 2002.

**Jeanne B. LeFevre**

**Updated: January 2008**

# Gift Ban Law and Rules for House Members and Employees

***What does the gift ban law prohibit?***

Legislators and legislative employees must not request or accept a gift from a lobbyist or principal, and lobbyists and principals must not give a gift to a legislator or legislative employee or ask someone else to do so. 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 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.

**Nina Manzi**

**Updated: January 2008**

# Minnesota's Individual Income Tax

***How much are income tax revenues?***

Minnesota's income tax revenues are projected to equal $7.7 billion in fiscal year 2008, about 45 percent of state tax collections and 38 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.

In calculating MTI, taxpayers must 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 has not conformed to federal changes to the definition of FTI for tax years 2007 and later. Taxpayers must use form M1NC to undo the recent federal changes to FTI before calculating their Minnesota tax. Some taxpayers will have to recompute federal phaseouts of items such as personal and dependent exemptions and medical expenses. Others will simply have to add back deductions allowed at the federal but not the state level, including:

- higher education tuition and fees deduction,
- teacher classroom expenses deduction, and
- exclusion for IRA distributions made to charities.

Minnesota taxpayers are allowed the following 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 2008 (brackets for married taxpayers, filing separately, are half the width of the married joint brackets):

| | **Married Joint** | **Single** | **Head of Household** |
|---|---|---|---|
| **5.35%** | First $31,860 | First $21,800 | First $26,830 |
| **7.05%** | $31,861 to $126,580 | $21,801 to $71,590 | $26,831 to $107,820 |
| **7.85%** | All over $126,580 | All over $71,590 | All over $107,820 |

A married couple filing a joint return owes income tax equal to 5.35 percent of their first $31,860 of taxable income, 7.05 percent of income between $31,860 and $126,580, and 7.85 percent of taxable income over $126,580. 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 ($62.6 million in fiscal year 2008)
- Long-term care insurance credit ($8.9 million in fiscal year 2008
- Credit for taxes paid to other states ($100.8 million in fiscal year 2008)

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 ($11.6 million in fiscal year 2008)
- Working family (earned income) credit ($141.2 million in fiscal year 2008)
- K-12 education credit ($15.3 million in fiscal year 2008)

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*, December 2006; *The Federal Earned Income Credit and the Minnesota Working Family Credit,* December 2007; *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2006; and *Income Tax Terms: Deductions and Credits*, July 2007.

# HOUSE RESEARCH | Short Subjects

Colbey Sullivan

January 2008

# Fixed and Variable Subsidies for Renewable Energy Producers: Two Policy Tools

***What is a subsidy?***

In general, a subsidy occurs when a governing body gives an economic "boost" to a specific segment of society in order to promote a desired outcome. Subsidies are a common public policy tool. Examples include free or reduced price meals for schoolchildren, tax abatements for specific businesses, and direct cash payments to Minnesotans turning corn into ethanol.

***How many states subsidize renewable energy producers?***

Focusing specifically on renewable transportation fuel, Minnesota is one of 21 states that subsidize producers of biofuels—mainly ethanol and biodiesel. State support is generally in the form of cash payments or tax breaks tied to the number of gallons produced.

***Why do governments subsidize renewable energy producers?***

Proponents argue that subsidies are necessary to:

- provide startup financing not otherwise available in the private financial markets;
- aid the development and growth of promising renewable industries until they can compete on a price basis with established energy technologies like gasoline produced from petroleum or electricity created by burning coal; and
- fully compensate renewable energy producers for the environmental and energy security benefits they provide.

Opponents counter that:

- the marketplace, not government, should decide which energy projects are worthy of investment; and
- environmental and energy security benefits are debatable and difficult to measure.

***What are fixed and variable subsidies?***

Fixed subsidies provide a consistent level of financial support from one period to the next. An example is Minnesota's ethanol producer payment program, enacted in 1986. In general, eligible producers have received, and some continue to receive, 20¢ per gallon for a portion of their annual ethanol production.

Variable subsidies, by contrast, can vary from period to period based on the current economic health of the industry. When times are tough, the government provides assistance to keep the companies afloat; when times are good, little or no support is extended. Variable subsidies are a component of federal farm policy. The U.S. Department of Agriculture calculates counter-cyclical deficiency payments using the relationship between market and "target" prices for covered crops. If the market price is below the target price, the government pays farmers the difference.

***What are the potential advantages and disadvantages of each?***

Fixed subsidies are predictable from one period to the next, making them easier to administer and budget. However, fixed subsidies do not account for any change in the subsidized industry's viability. For example, fixed subsidies may continue once the industry's fortunes have improved and the industry is profitable without government support.

Fluid by design, variable subsidies react to current conditions and may provide a superior level of support for renewable energy producers and investors at a lower cost to taxpayers. However, variable subsidies are more complex to budget and administer. Depending on how the policy is designed, variable subsidies may further distort economic decision making or fail to provide adequate support for less competitive renewable energy projects.

***Are there any states that use variable subsidies for biofuels?***

In 2003, North Dakota enacted the nation's only market-based variable subsidy for ethanol producers. Payments are calculated using a formula that estimates the current profitability of eligible ethanol plants.

Each quarter, North Dakota's Agricultural Products Utilization Commission compares the market prices of ethanol and corn with target prices established by law. When ethanol prices are low and/or corn prices are high for the period, eligible plants receive a subsidy payment. When prices are favorable, no support is provided.

**For more information:** Contact legislative analyst Colbey Sullivan at 651-296-5047. For more on renewable energy subsidies and a hypothetical illustration of the cost and performance of fixed and variable subsidies for ethanol producers, see the House Research publication *Designing Incentives for Renewable Energy Producers: Fixed v. Variable Subsidies*, January 2007.

Nina Manzi

March 2008

# Federal Recovery Rebates

***What are federal recovery rebates?***

The federal Economic Stimulus Act of 2008 (Public Law 110-185) provides for "recovery rebates" to be paid as a refundable advance credits against 2008 federal income tax liability.

***Who is eligible for a rebate?***

Anyone with federal income tax liability for tax year 2007 is eligible for a rebate. Individuals with "qualifying income" of at least $3,000 in 2007 are also eligible. "Qualifying income" is defined as:

- earned income (wages and self-employment income);
- Social Security and railroad retirement benefits (both taxable and nontaxable);
- nontaxable combat pay; and
- disability, pension, and survivor benefits paid by the U.S. Department of Veterans Affairs (both taxable and nontaxable).

Individuals who are eligible as a result of having at least $3,000 of qualifying income in 2007 must file a 2007 federal income tax return in order to receive a rebate, even if they aren't otherwise required to file a return.

Individuals who do not have federal liability or at least $3,000 of qualifying income in 2007 may qualify to receive a refund if they have federal income tax liability or at least $3,000 of qualifying income in 2008.

***How much are the rebates?***

For individuals who qualify because they have federal income tax liability for 2007, the rebate amount is calculated as shown in the table.

| | Federal income tax | Rebate equals |
|---|---|---|
| Married joint filers | More than $1,200 | $1,200 plus $300 per qualifying child |
| | $600 to $1,200 | Federal tax plus $300 per qualifying child |
| | Less than $600* | $600 plus $300 per qualifying child |
| All other filers | More than $600 | $600 plus $300 per qualifying child |
| | $300 to $600 | Federal tax plus $300 per qualifying child |
| | Less than $300* | $300 plus $300 per qualifying child |

*Must have gross income of at least $17,500 (married joint), $8,750 (married separate or single), or $11,250 (head of household)

For individuals who are eligible because they have at least $3,000 of qualifying income, the rebate equals $600 for married joint filers ($300 for all other filers), plus $300 for each qualifying child.

"Qualifying child" follows the definition used for the federal child tax credit: an individual eligible to be claimed as the taxpayer's dependent who was under age 17 as of December 31, 2007.

***Are rebates phased out based on income?***

Yes, rebates are reduced by 5 percent of adjusted gross income over $150,000 for married joint filers ($75,000 for all other filers), as shown in the table.

| | Phaseout starts | Rebate fully phased out |
|---|---|---|
| Married joint | | |
| No qualifying children | $150,000 | $174,000 |
| 1 qualifying child | $150,000 | $180,000 |
| 2 qualifying children | $150,000 | $186,000 |
| More than 2 children | $150,000 | $6,000 higher for each additional child |
| All other filers | | |
| No qualifying children | $75,000 | $87,000 |
| 1 qualifying child | $75,000 | $93,000 |
| 2 qualifying children | $75,000 | $99,000 |
| More than 2 children | $75,000 | $6,000 higher for each additional child |

***When will the rebates be paid?***

The U.S. Treasury Department will begin issuing rebates in early May 2008. Rebates will be issued separately from federal income tax refunds. Individuals who provide routing and account numbers on their federal income tax return will receive their rebates by direct deposit, even if they don't qualify for an income tax refund. All others will receive their rebates by check.

Individuals who are not eligible for a rebate based on 2007 federal liability or 2007 qualifying income, but who have federal liability or $3,000 of qualifying income for tax year 2008, will be able to claim a rebate when they file their 2008 income tax return (generally in January through April 2009).

***Are the rebates subject to federal or Minnesota income tax?***

No. Because rebates are a credit against federal tax liability, they are not taxable income (the federal definition of "taxable income" ensures that rebate payments that exceed liability are excluded).

Minnesota conforms to the federal definition of taxable income and will not tax federal recovery rebates.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204. Also see the IRS web site: http://www.irs.gov/irs/article/0,,id=177937,00.html.

Nina Manzi and Jim Cleary June 2008

# Minnesota Income Tax Credit for Past Military Service

***What is the new income tax credit for past military service?***

The 2008 omnibus tax bill (Laws 2008, ch. 366) provides for a new income tax credit for past military service. The credit equals $750 for qualifying individuals. It is nonrefundable and is subject to an income limitation. The credit takes effect beginning in tax year 2009 and will first be claimed on tax year 2009 returns filed in 2010.

***Who qualifies for the new credit for past military service?***

To qualify for the new credit, a veteran must:

- have served in the military (including the National Guard and reserves) for at least 20 years; or
- have a service-connected disability rated by the U.S. Department of Veterans' Affairs as being 100 percent total and permanent.

Individuals currently serving in the military do not qualify for the credit.

***What is a nonrefundable credit?***

A nonrefundable credit may be used only to offset Minnesota income tax liability. A veteran must have at least $750 of income tax liability to receive the full credit amount. A qualified veteran with less than $750 of state income tax liability would be eligible for an amount of credit equal to the amount of liability. A qualified veteran with no state income tax liability would not receive a credit.

In tax year 2009, when the credit takes effect, a single veteran with no dependents who claims the standard deduction would need to have $23,270 of federal adjusted gross income to receive the full $750 credit.

***How does a nonrefundable credit compare with an income tax subtraction?***

A nonrefundable credit has an effect on final liability similar to that of an income tax subtraction. A credit is a dollar-for-dollar reduction in tax liability, while a subtraction reduces taxable income, which results in lower tax liability. The benefit from a subtraction depends upon the taxpayer's tax bracket or rate. Because of the income limits, veterans who qualify for the credit will be in the bottom or lowest tax bracket with a rate of 5.35 percent. The $750 nonrefundable military service credit is equivalent to a $14,020 income tax subtraction ($14,020 times 5.35 percent, the state income tax rate for the first bracket of taxable income, equals $750).

Only individuals with tax liability will benefit from either a nonrefundable credit or a subtraction, and the amount of the benefit is limited to their tax liability.

***How is the military service credit income-limited?***

The military service credit is phased out for individuals with federal adjusted gross income (FAGI) of $30,000 or more. The credit is reduced by 10 percent of FAGI in excess of $30,000, so that individuals with FAGI over $37,500 are not eligible for a credit.

FAGI is calculated on the federal tax forms (lines 37 on Form 1040, line 21 on Form 1040A, and line 4 on Form 1040EZ for tax year 2007). It includes most kinds of income, such as:

- wages, salaries, and tips;
- taxable interest;
- dividends and capital gains or losses;
- business income or loss, including income from partnerships and S corporations;
- taxable IRA, pension, and annuity distributions;
- farm income or loss;
- unemployment compensation; and
- taxable Social Security benefits (the amount of Social Security benefits that are taxable depends on the individual's income level; at most, 85 percent of benefits are included in federal adjusted gross income).

Some of the major items excluded from FAGI are:

- deductible retirement plan contributions;
- nontaxable employee fringe benefits;
- student loan interest payments;
- one-half of self-employment tax; and
- health insurance premiums (for self-employed taxpayers only).

***What are some examples of individuals who will and will not receive the new military service credit?***

Qualifying veterans with less than $30,000 in taxable military retirement income, and no other income other than Social Security, would qualify for up to the maximum $750 credit. The actual credit received would depend on the individual's tax liability. Since Social Security benefits are not included in FAGI for low-income filers, receipt of Social Security will not subject an individual to the income-based phaseout.

Qualifying veterans employed in second careers and with FAGI over $37,500 will not receive the credit due to the income phaseout. Those employed in second careers will be eligible for a full or partial credit if their federal adjusted gross income is less than $37,500.

Qualifying veterans who are 100 percent totally and permanently disabled might or might not receive the credit depending on the amount of the veteran's taxable income (military disability pay itself is nontaxable). With no taxable income or with more than $37,500 of adjusted gross income, such disabled veterans would receive no credit. Conversely, with any amount of taxable income greater than zero and less than $37,500, the disabled veteran would receive a full or partial credit.

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

HOUSE RESEARCH | Short Subjects

Patrick McCormack

Updated: June 2008

# Minnesota's Three-Tier System of Liquor Regulation

Liquor is controlled for a number of reasons: to deny access to minors, to limit over-consumption, to ensure public safety via a clean supply, and to allow community control over the type and nature of liquor venues. Liquor is a public concern because a lack of control has caused public problems. Liquor is also regulated as an industry, both to compel the industry to meet the public goals of the state and to ensure fair competition.

***The three-tier system of regulation***

The classic model of liquor regulation creates a three-tier system for supply and distribution. This structure was created after Prohibition in order to modulate the free-wheeling system in place before Prohibition, which was deemed problematic. One aspect of that pre-Prohibition system was the existence of "tied houses"—retailers owned by manufacturers and serving as aggressive sales outlets for those manufacturers.

Minnesota has a much-modified version of the three-tier system. In a pure three-tier, manufacturers make spirits, beer, and wine; wholesalers distribute across and within the state to retailers; and retailers sell to the consuming public.

There are other models for regulating the sale of alcoholic beverages. Some states are "control" states, where wholesalers (18 states) and retailers (14 states) are operated in whole or in part by the State. The other 32, including Minnesota, are "license" states, allowing sales for the most part through independent licensed businesses. In Minnesota, municipal liquor stores do exist at the discretion of the municipality.

***The first tier: Manufacturers***

As of 2006, Minnesota had seven licensed manufacturers. Two of these manufacture distilled spirits and five brew beer. Brew-pubs (18) and wineries (22) have separate licenses and are not considered manufacturers.

***The second tier: Wholesalers***

As of 2006, there were 147 wholesaler permits issued (this number excludes farm wineries). Among the 147 permits, there are only seven liquor wholesalers. The rest are beer or wine wholesalers.

***The third tier: Retailers***

There are over 5,000 retail liquor establishments in Minnesota, divided among a wide variety of types. There are about 2,800 on-sale licensees and almost 500 club licensees. There are over 800 off-sale licensees and just under 1,200 combination off-sale/on-sale licensees. In addition to these categories, there are over 800 wine or wine/strong beer licensees and almost 400 establishments that have consumption and display permits. Finally, there are over 250 municipal on-sale or combination on-off sale licensees.

***Exceptions to the three tiers***

The three-tier system in Minnesota is not pure. The state has granted numerous exceptions, which has created a modified three-tier structure.

Some exceptions apply mostly to manufacturers:

- Brew-on-premises stores: These stores allow consumers to be manufacturers of beer (Minn. Stat. § 340A.33) or wine (Minn. Stat. § 340A.34) for private use

Some exceptions apply mostly to wholesalers:

- Nonprimary source state: Minnesota is the only nonprimary source state, which means that a wholesaler does not have to purchase all product directly from a manufacturer, but can instead buy the manufacturer's product from third parties, essentially other wholesalers, on the global market (Minn. Stat. § 340A.305, subd. 4)

Some exceptions apply mostly to retailers:

- Municipals and nonmunicipals: Minnesota allows municipal liquor stores to operate as a monopoly and also allows local governments to license multiple private stores, creating two different retail systems (Minn. Stat. § 340A.601)
- Bed and breakfast establishments can sell up to two glasses of wine with a stay at their establishment without a license (Minn. Stat. § 340A.4011)
- 3.2 percent malt liquor has separate sales provisions, including allowing sales at grocery stores, convenience stores, etc. (Minn. Stat. § 340A.403)
- Culinary classes are allowed to serve a limited amount of alcohol (Minn. Stat. § 340A.4041)

Some exceptions apply to more than one tier:

- Brew pubs: These retail outlets are allowed to manufacture their own beer, and in some instances, to transport it between multiple locations owned by the same company (Minn. Stat. § 340A.301, subd. 6); they can also sell growlers, or smaller 750 milliliter bottles, for people to take home and consume (Minn. Stat. § 340A.301, subd. 7b)
- Farm wineries (Minn. Stat. § 340A.315): A farm winery in Minnesota can give free samples, sell bottles of their product (Minn. Stat. § 340A.301, subd. 8), even on Sundays, and operate restaurants or wine bars that offer their product (Minn. Stat. § 340A.315); farm wineries may also produce distilled spirits and provide samples of distilled spirits, but may only sell distilled spirits through existing wholesalers (Minn. Stat. § 340A.315, subd. 7)
- Wine over the Internet: Minnesota law allows the purchase and direct shipment (Minn. Stat. § 340A.417) of two cases of wine from a winery, over the Internet, and also allows Minnesota wineries to sell two cases to a given consumer, thereby allowing these manufacturers to act as direct retailers

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

Nina Manzi and Jim Cleary

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# 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)
- If the individual had other Minnesota source income during the tax year
- If the individual is a Minnesota resident
- If the individual is in the regular 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 generally 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 all types of military pay earned outside Minnesota. Some common situations include the following:

- Members of the full-time military in active service whose spouses are employed and live in Minnesota
- Members of the National Guard and reserves in active service outside Minnesota for the entire tax year who have employed spouses living in Minnesota, or whose civilian employer provides a salary differential
- Members of the National Guard and reserves in active service 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

For tax years 2005 through 2007, pay for National Guard training under Title 32 that occurs outside Minnesota was not allowed as a subtraction. Laws 2008, chapter 154, added this category of pay, beginning in tax year 2008.

***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 earned in Minnesota. 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***

Beginning in tax year 2009, individuals who serve in Minnesota and are Minnesota residents, other than active guard and reserve (AGR) personnel, may 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 members of the Coast Guard, and recruitment officers. This new subtraction does not apply to AGR personnel and to certain other limited categories of state service.

***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, cl. (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).

Beginning in tax year 2009, "qualifying active service" also includes weekend drills and annual training (summer camp), and special school attendance.

"Qualifying active service" excludes service by AGR personnel and by former members of the National Guard ordered to active service by the adjutant general to perform administrative duties.

***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**

**Patrick McCormack** **Updated: June 2008**

# Minnesota's Laws on Wine Tasting and Samples of Alcohol

Minnesota Statutes make a distinction between the regulations for the tasting of wine and the provision of free samples of wine, beer, and liquor.

***Free Samples***

Minnesota Statutes, section 340A.510, allows a liquor store, bar, or municipal liquor store to either offer free samples directly, or to allow a licensed manufacturer or wholesaler to provide samples on their premises. Sample sizes are limited to 100 milliliters for malt liquors, 50 milliliters for wine, 25 milliliters of liqueur or cordial, and 15 milliliters of distilled spirits. Samples must be of beverages that are otherwise for sale.

Samples may not be offered at retail establishments that do not hold an on-sale, off-sale, or municipal liquor license. Minnesota law is silent on whether brewery tours may offer samples, although there is no direct prohibition, and taxes are not collected on beer served on-site at the brewery (Minn. Stat. § 297G.07, subd. 1 (4)).

A farm winery may give free samples of its products (Minn. Stat. § 340A.315), and in 2007, farm wineries were given permission to hold other licenses, including on-sale licenses in order to operate bars or restaurants. In 2008, farm wineries were allowed to produce distilled spirits and to give 15-milliliter samples of each variety produced.

***Culinary Classes***

A limited on-sale liquor license may be issued to establishments that conduct culinary classes, and under this license, participants may be served up to six ounces of wine or 12 ounces of intoxicating malt liquor, for consumption on the premises. As an alternative, a culinary establishment may hold a regular on-sale license and serve beverages under general on-sale laws. Culinary establishments may only hold a regular on-sale license if they are also a restaurant, hotel, etc.

***Tastings***

A holder of an on-sale intoxicating liquor license may hold wine, beer, or distilled liquor tastings as part of the normal operation of the bar or restaurant, and would then charge a fee per glass consumed. Minnesota law does allow charitable, religious, or other nonprofit groups to conduct wine tastings, defined as "an event at which persons pay a fee or donation to participate, and are allowed to consume wine by the glass without paying a separate charge for each glass."

Tastings are limited as follows:

- There is no provision allowing nonprofits or charities to conduct tastings of beer, distilled spirits, or anything other than wine

- A temporary on-sale liquor license must be held by the charity or nonprofit, allowing a tasting for up to four hours per event
- No wine at a wine tasting may be sold, or orders taken, for off-premises consumption
- A charity or nonprofit may conduct a wine tasting at its own premises, a donated premises, or at an establishment run by the holder of a permanent on-sale license
- A licensed wine wholesaler may sell or give wine to the organization and may provide personnel to assist at the event
- Net proceeds must be used for the organization's primary nonprofit purpose, or if two nonprofits cooperate in conducting the event, for either organization's primary nonprofit purposes
- A special provision allows more extensive tastings at food and wine conventions, which may take place over three days

Minnesota Statutes, section 340A.419, also allows wine tastings to be conducted by an exclusive liquor store, on the premises of a holder of an on-sale liquor license. The law prohibits the liquor store from selling the wine at the event, but does allow forms indicating wine preferences to be filled out. Fees charged may only be used to defray costs, and cooperation with wine wholesalers is allowed.

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

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

**Joel Michael**

**Updated: June 2008**

# Constitutional Restrictions on State Taxation: The Prohibition on Discriminating Against Interstate Commerce

Legislators often seek to favor Minnesota businesses in setting state tax policy. They may propose limiting tax preferences to Minnesota-based businesses and activities, or suggest imposing taxes that fall exclusively or more heavily on out-of-state businesses. Many of these proposals violate the Commerce Clause of the United States Constitution because they discriminate against interstate commerce. This short subject describes the constitutional prohibition on discriminating against interstate commerce. This is a complicated legal topic; in many cases the applicable rules are unclear. An expert needs to carefully analyze the constitutionality of any legislative proposal.

**General Rule.** The Commerce Clause grants Congress the power "to regulate commerce * * * among the several states * * *." U.S. Const. art. II, § 8. However, the United States Supreme Court has long held that a negative implication of this grant of power is that states may not adopt regulations or taxes that place an "undue burden" on interstate commerce, even if Congress has taken no action. This is referred to as the "dormant" or "negative" Commerce Clause doctrine. The Commerce Clause is a principal reason for the federal constitution: that is, to join the states in a national economy and to prevent the fragmentation that resulted from individual states imposing tariffs and laws favoring local merchants.

In *Complete Auto Transit v. Brady,* 430 U.S. 274 (1977), the Court set out a four-part test for state taxes to be valid under the Commerce Clause. The tax must:

- Be applied to an activity that has substantial nexus with the state;
- Be fairly apportioned to activities in the state;
- Not discriminate against interstate commerce;
- Be fairly related to services provided by the state.

The most frequently litigated and arguably the most important of these four rules is the prohibition on discriminating against interstate commerce. It is a longstanding rule, dating to the late 19th century. The Court has described the rule as follows:

> [N]o State, consistent with the Commerce Clause, may "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to a local business." This antidiscrimination principle "follows inexorably from the basic purpose of the Clause" to prohibit the multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution. *Maryland v. Louisiana*, 451 U.S. 725, 754 (1981) (citations omitted).

The Court has held that state tax provisions may not favor local business firms, local products, or local activities. However, some provisions favoring local businesses may be valid, if they are properly structured and designed.

**Specific Principles and Examples.** The Court has invalidated many state taxes on the grounds they discriminate against interstate commerce. Some general principles from these cases include the following:

- **"Facial" discrimination almost always will invalidate a tax.** If a tax explicitly ("on its face") favors local businesses, local transactions, or products, it will almost always be held to discriminate against interstate commerce. For example, the Court held invalid:

- Exempting ethanol or alcoholic beverages produced only within the state. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988);
- Exempting dividends paid by in-state corporations. *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996);
- Providing reduced tax rate for in-state transactions. *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977); and
- Limiting charitable contribution deductions to in-state charities. *Chapman v. Commissioner of Revenue*, 651 N.W.2d 825 (Minn. 2002).

- **Discrimination is determined by economic effect.** It is not necessary that the state or the legislature intend to discriminate, if the provision has the economic effect of discriminating. However, showing intent to discriminate is relevant; a legislative intent to discriminate is nearly conclusive of the tax's unconstitutionality.

- **The tax will be invalidated, even if discrimination is minor or seems inconsequential.** The Court has rejected arguments that the effect of the discrimination is so minor or *de minimis* that it is not of constitutional stature.

- **Incentives to encourage local investment or activity may be invalid.** Tax incentives for in-state activity (e.g., investment or exporting) may be invalid, if the net effect raises the underlying tax on out-of-state businesses. For example, the Court struck down an income tax credit to encourage businesses to export through in-state corporations. *Westinghouse Electric v. Tully*, 466 U.S. 388 (1984).

However, sales tax incentives (e.g., capital equipment exemptions) or property tax incentives (e.g., tax increment financing) are likely valid, because the underlying taxes apply only to in-state property or transactions. Incentives may be validly provided through direct spending programs (e.g., grants), unless they are linked to a discriminatory tax or other funding source. *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994).

**Discriminatory Taxes May Be Valid as Complementary Taxes.** An otherwise discriminatory tax may be a valid "complementary" tax, if it offsets a specific tax that only a local business or transaction bears. The classic case is the use tax, which complements the sales tax. Sales taxes apply to in-state purchases, but not to purchases made outside the state, such as by phone, mail order, or the Internet. To prevent disadvantaging local merchants, the Court upheld a "complementary" use tax, a tax on "using" a product or service in the state that was purchased from out-of-state sellers. *Hennford v. Silas Mason Co.*, 300 U.S. 577 (1937). The Court, however, has construed this exception very narrowly; so far, it has only applied it to the use tax.

**State taxes may discriminate in favor of in-state governmental entities.** In two recent cases, the Court has upheld facially discriminatory state laws that favored in-state governmental entities. In *Dept. of Revenue of Kentucky v. Davis*, 128 S. Ct. 1801 (2008), the Court upheld a tax imposed only on government bonds issued by out-of-state entities and in *United Haulers Ass'n., Inc. v. Oneida-Herkimer Solid Waste Management Authority,* 550 U.S. – (2007), the Court upheld a "flow-control" ordinance that granted a monopoly to a governmental waste disposal enterprise. The exact scope of this new governmental entity exemption is unclear, but it clearly cannot favor in-state businesses.

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

Joel Michael

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# Single Sales Apportionment of Corporate Franchise Tax

*Apportionment is a key feature of state 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 using the Minnesota proportions of the corporation's sales, payroll, and property factors to determine corporate franchise tax.

*Minnesota is phasing in single sales apportionment*

Under legislation enacted in 2005, Minnesota is phasing in single sales apportionment over an eight-year period beginning in tax year 2007. For tax years 2001 through 2006, Minnesota used a three-factor, weighted formula (75 percent sales, 12.5 percent payroll, and 12.5 percent property). The table shows the phase-in schedule for the transition to single sales apportionment from 2008 to 2014.

| Tax year | Sales | Property | Payroll |
|---|---|---|---|
| 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 is. A classic example is a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but 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.

***Sales weighted apportionment reduces revenues***

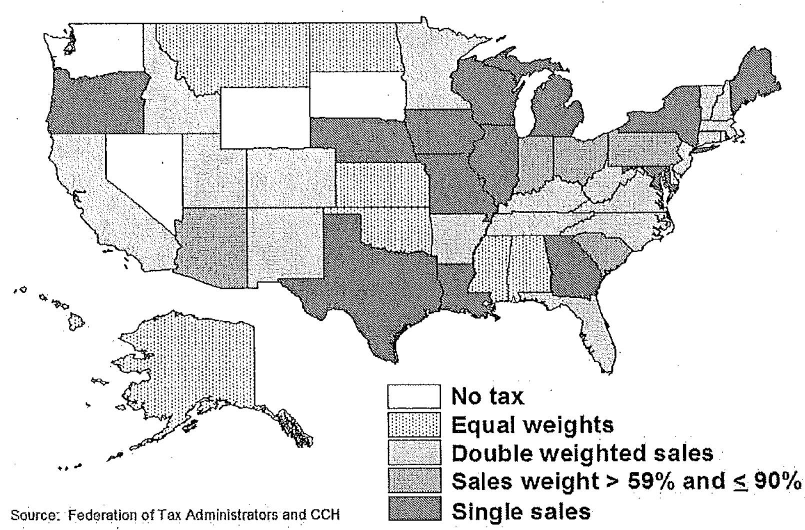
As compared with equally weighting each of the apportionment factors, weighting sales more heavily reduces Minnesota tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2008) shows an expenditure cost of $172 million for fiscal year 2009. This rises to $180 million in 2010 under the phase-in.

***Trend in other states to heavier sales weighting***

States have been increasingly shifting their apportionment formulas to more heavily weighted sales. Effective for tax year 2008, 14 states will use or allow 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, Michigan, Missouri, Nebraska, and Wisconsin. Colorado is scheduled to use single sales in 2009, Indiana in 2011, and South Carolina in 2013. The map below shows the apportionment formulas for manufacturers as of tax year 2008. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.

**Apportionment of Corporate Income**

**Applicable to Manufacturers**




**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.

Matt Gehring

June 2008

# Minnesota's Voter Eligibility and Identification Requirements

***What are the eligibility requirements to vote in Minnesota?***

A person may vote in Minnesota on election day if the person:

- is at least 18 years old on election day;
- is a citizen of the United States;
- will have resided in Minnesota for at least 20 days immediately preceding election day;
- is not under a court-ordered guardianship in which the right to vote has been revoked; and
- is not considered legally incompetent to vote, as determined by a court.

A person who has been convicted of a felony may vote only if the felony sentence has expired or has been discharged by a court.

***What identification is required to cast a ballot on election day in Minnesota?***

Voters who have **previously registered to vote in Minnesota,** either by mail or by registering at the polling place on a previous election day, are required to state their name to the appropriate election judge and sign a polling place roster. The election judge may ask voters to confirm their address and/or date of birth.

By signing the polling place roster, voters confirm their eligibility to vote and their understanding of the penalty for providing false information. The eligibility requirements and penalties for false information are written on each roster page.

Voters who have **not previously registered to vote using their current Minnesota address** may register at the polling place on election day. To register, voters must complete an application, make an oath, and prove their residence. To prove residence, a voter must present *one* of the following:

- A valid Minnesota driver's license, learner's permit, Minnesota identification card, or a receipt for one of these documents, provided that the document presented contains a valid current address in the precinct
- A valid registration in the precinct under a different name or address
- A notice of late registration sent to the voter from the county auditor or municipal clerk
- A tribal identification card issued by the government of a tribe recognized by the Bureau of Indian Affairs that contains the name, address, signature, and picture of the voter

- A Minnesota driver's license, identification card, U.S. passport, U.S. military identification card, tribal identification card that contains the voter's signature, or Minnesota postsecondary institution identification card, along with a bill that contains the voter's current address in the precinct, dated within 30 days before or after the election. The following types of bills meet this requirement: electric, gas, water, solid waste, sewer, telephone, television, and Internet. Instead of a utility bill, a voter may present a rent statement from the voter's landlord if it contains itemized utility expenses, or a student fee statement that contains the student voter's valid address in the precinct.
- Another voter who is registered to vote in the precinct, or who is employed by a residential facility in the precinct and vouching for a resident in the facility, who knows that the registering voter is a resident of the precinct and who will vouch for that fact
- A current student identification card with a photo, if the college or university has provided a student housing list to the appropriate election officials. Historically, student housing lists have been provided by most major public and private four-year colleges and universities in the state.

***Does the recent U.S. Supreme Court decision permitting Indiana to require photo identification to vote affect Minnesota's requirements?***

The United States Supreme Court recently addressed voter identification requirements in *Crawford v. Marion County Election Board*, 128 S.Ct. 1610 (2008). The case arose after Indiana passed a law requiring voters to show photo identification at the polls. Those opposed to the law argued that it imposed an unconstitutional undue burden and disenfranchised some voters.

In considering the challenge, the Court balanced the interests asserted by the state to justify the law with the potential burdens that may be imposed on voters as a result of the law. The Supreme Court upheld the new requirements as constitutional, finding Indiana had several legitimate interests relevant to protecting the integrity and reliability of elections, and that these interests outweighed the potential burden on voters created by the new requirements. These interests included: (1) deterring and detecting voter fraud; (2) improving antiquated election procedures; (3) preventing fraud made possible by the names of deceased people and nonresidents that are still on voter rolls; and (4) protecting public confidence in elections.

The Court's decision in *Crawford* does not mandate that all states enact a law requiring photo identification at the polls and does not impact the requirements for voting in Minnesota. Minnesota law does not require a voter to present photo identification in order to vote. However, if the Minnesota Legislature were to enact a photo identification requirement in the future, courts would look to the *Crawford* decision as precedent if the law were challenged on constitutional grounds.

**For more information on elections:** Contact legislative analyst Matt Gehring at 651-296-5052, or visit the elections portion of our website, www.house.mn/hrd/issinfo/elect.htm.

Colbey Sullivan Updated: July 2008

# The Ethanol Industry in Minnesota

Ethanol—an alcohol commonly produced by fermenting the starch in field corn—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 the state and federal levels, Minnesota ethanol production has grown significantly—from less than 1 million gallons in 1987 to a projected 1 billion gallons by the end of 2008.

***Federal fuel tax credit for ethanol***

A person who blends ethanol with gasoline is eligible for a refundable credit against his or her federal fuel tax liability. Currently the credit is 51 cents per gallon of ethanol blended but the amount will likely decrease by six cents per gallon beginning in 2009. 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 infrastructure. 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 20 cents per gallon of ethanol produced, subject to certain limitations. For years 2004 through 2007, the payments were reduced to 13 cents per gallon, with a pledge to make up the remaining seven cents per gallon at a later date. The program closed to new applicants in 2000.

***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 at least 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***

At least 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. At least nine 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***

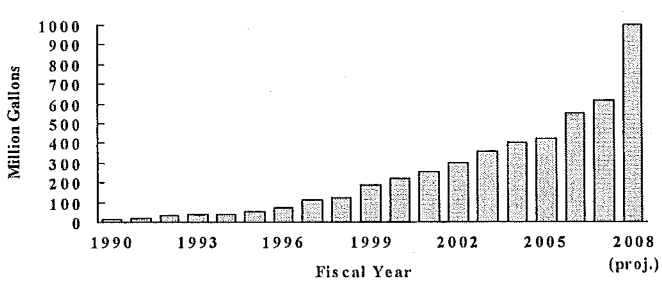
Since 2003, almost all of the gasoline sold in the state must contain 10 percent ethanol (E10). Exemptions include gasoline used for motor sports racing, airports, marinas, motorcycles, off-road vehicles, small engines, and collector vehicles. The legislature initially required a statewide blend of at least 7.7 percent ethanol in 1997.

In 2005 the legislature went a step further, requiring E20 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.

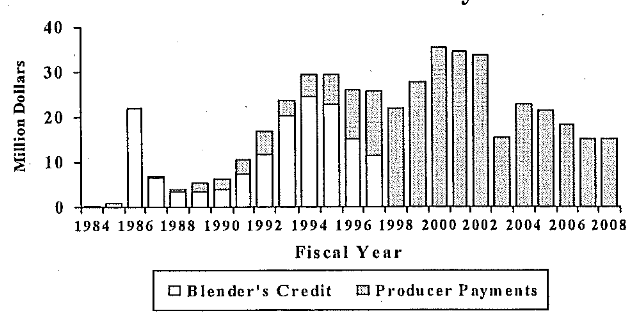
***E85 promotion***

Since 1995, the state has taxed E85 at a lower rate than E10 and pure gasoline. 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. Laws in 2005, 2007, and 2008 approved a total of $2,250,000 in grants to partially reimburse service station owners who install E85 dispensing pumps. A 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**

**Emily Cleveland**

**Updated: July 2008**

# Minors' Consent for Health Care

Minors may not receive health care services without their parents' or guardians' consent, unless specified otherwise in statute.

***Specific Services***

A minor may consent for medical, mental, or other health services for the following:

- to determine the presence or treatment of pregnancy and conditions associated with pregnancy
- for sexually transmitted infections
- for alcohol or other drug abuse (Minn. Stat. § 144.343, subd. 1)

In addition, minors may consent for:

- hepatitis B vaccinations (Minn. Stat. § 144.3441) and
- blood donation (only those 17 and over) (Minn. Stat. § 145.41).

***Emergency Treatment***

Health services may be provided to minors without the consent of a parent if, in the health professional's judgment, treatment should be given without delay, and if obtaining consent would result in delay or denial of treatment (Minn. Stat. § 144.344).

***Abortion***

Minors seeking an abortion must notify both parents of the intended abortion and wait 48 hours, or seek judicial approval for the procedure. A court may authorize an abortion if it finds either:

- that the pregnant minor is mature and capable of giving informed consent, or
- that authorizing the abortion without notification would be in her best interests.

An expedited, confidential appeal is available to any minor for whom the court denies an order authorizing an abortion without notification. An order authorizing an abortion without parental notification is not subject to appeal (Minn. Stat. § 144.343, subds. 2-7).

***Marriage or Giving Birth***

Any minor who has been married or has given birth may consent for personal medical, mental, dental, or other health services or for services for the minor's child (Minn. Stat. § 144.342).

***Voluntary Institutional Treatment***

Any person 16 years or older may request informal admission to a treatment facility for observation or treatment of mental illness, chemical dependency, or mental retardation and may give valid consent for hospitalization, routine diagnostic evaluation, and emergency or short-term acute care (Minn. Stat. §§ 253B.03, subd. 6(d); 253B.04, subd. 1).

| | |
|---|---|
| ***Access to Health Records*** | Parents and guardians have access to their minor children's medical records, unless the minor legally consents for services specifically listed under the Consent of Minors for Health Services statute (Minn. Stat. §§ 144.341-144.347). In that case, parents or guardians do not have access to the minor's health care records without the minor's authorization (Minn. Stat. § 144.291, subd. 2, para. (g)). However, if a health professional believes that it is in the best interest of the minor, the health professional may inform the minor's parents of the treatment (Minn. Stat. § 144.346). |
| ***Living Apart from Parents and Managing Own Financial Affairs*** | A minor living apart from his or her parents or legal guardian and who is managing his or her own financial affairs may consent for his or her own medical, mental, or dental care services. This exception applies to a minor regardless of whether the minor's parents have consented to the minor living apart, or regardless of the extent or source of the minor's income (Minn. Stat. § 144.341). |
| ***Representation to Persons Rendering Service*** | If a minor represents to a health professional that he or she is able to give effective consent for medical, mental, dental, or other health services, but is in fact not able to do so, his or her consent is effective if relied upon in good faith by the person rendering the health service (Minn. Stat. § 144.345). |
| ***Financial Responsibility*** | A minor who consents for health services is financially responsible for the cost of the services (Minn. Stat. § 144.347). |

**For more information:** Also see the House Research publication *Youth and the Law*, December 2006.

Lisa Larson July 2008

# Measures of Student Learning and School Accountability

***Policymakers are debating how to reconcile student achievement and growth measures***

The anticipated reauthorization of the federal No Child Left Behind Act (NCLB) and a state requirement that the Education Commissioner include a value-added component on the school report card by the 2008-2009 school year have led to a discussion about the student academic achievement model used to calculate adequate yearly progress and identify successful and failing schools. The legislature is considering the use of two different measures to determine student achievement: an achievement measure that shows what students have achieved at one point in time and a growth measure that shows how much progress students have made between two points in time.

The 2008 Legislature passed a bill adding a student growth measure with a value-added component onto the school report card, and the governor vetoed the bill. The federal law does not allow the value-added growth model for *federal* accountability because the model does not require all students to become proficient in reading and math by the 2013-2014 school year. However, the federal law does not prevent a state from using a value-added growth model for *state* accountability.

***NCLB requires public schools to close the academic achievement gap among groups of students***

Under NCLB, schools and districts must show that they are making "adequate yearly progress" (AYP) sufficient to ensure that all students are proficient in reading and math. A major purpose of this law is to help states close the academic achievement gap that exists among different groups of students in many public schools, including students who are identified as members of racial and ethnic minority groups, those with limited English proficiency, those who are economically disadvantaged, and students with disabilities. The federal law imposes consequences and redirects the federal resources of schools that fail to sufficiently improve the test scores of low-performing students.

***Schools that fail to make AYP for at least two years are considered to be "failing"***

To comply with the federal law, Minnesota's accountability plan identifies student "performance indicators" that it uses to determine which schools are making AYP. Student performance indicators must include reading and math proficiency, participation rates on reading and math assessments, high school graduation rates, and a K-8 indicator. All students in all groups must achieve proficiency on Minnesota's reading and math tests by the 2014 deadline. Schools where enough additional students in identified groups fail to achieve proficiency on state reading and math tests for two consecutive school years or more acquire the status of "failing" and are subject to increasingly severe sanctions.

***AYP does not account for students' initial performance levels***

As required by NCLB, AYP uses an achievement measure to assess student learning. Critics have contended that this requires schools to demonstrate significant academic achievement for all students without taking into account students' initial performance levels. As a result, schools are judged in part by how much knowledge students bring with them to school. Also, different schools are subject to different standards because some must show only small academic gains and others must show very large academic gains in order to make AYP.

***Achievement measures show proficiency of each student "subgroup" at one point in time***

To measure student performance and develop a more complete picture of student learning, some policymakers advocate using existing annual state test data to report two different but complementary school measures.

Minnesota currently uses an academic **achievement measure** to calculate AYP. This achievement measure shows what students have achieved at one point in time on the state reading and math tests based on state standards of academic proficiency. The achievement measure defines "success" by the number of students in each identified group who are proficient on the state tests. The measure is affected by demographic and other factors outside the school. It does not report students' rate of progress toward proficiency or the amount of student progress beyond what is proficient.

***Growth measures show academic progress between two points in time***

A complementary student **growth measure** uses the same annual test data to determine how much academic growth or progress a student makes between two points in time. This measure can define "success" by how much a student learned compared with other students in similar circumstances. It is largely independent of demographic and other factors outside the school and more dependent on what happens in school. Schools can use **value-added growth** data to try to determine the impact of curriculum, instruction, programs, and practices on the rate of academic growth or progress of individual students and groups of students.

***A federal pilot program uses a growth model to project future student proficiency***

Eleven states currently participate in a federal growth model pilot program. Many use a model that identifies schools where students are projected to become proficient in the future, giving the schools more time to make students proficient. One difficulty with the projection model is that, like the achievement measure, it holds schools to different standards—schools with high initial achievement levels need to make only small learning gains and schools with low initial achievement levels need to make very large learning gains. Another difficulty is that this model expects students' learning gains to increase at a constant rate across grades although data suggest that the rate at which students learn decreases over time.

***A value-added growth model may be a fair way to compare schools' effectiveness***

Some policymakers argue that using a value-added growth model to measure the relative effectiveness of schools based on students' initial achievement levels is a fairer way to compare schools. They say that the model can be used to try to determine schools' impact on student progress and identify schools where students have low initial achievement levels and high academic growth and schools where students have high initial achievement levels and high academic growth. They argue that schools use such information to modify instruction and align professional development to better meet students' needs.

**For more information:** Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research publications *Minnesota's K-12 Academic Standards and Assessments,* August 2006, and *Adequate Yearly Progress Under the No Child Left Behind Act,* November 2003.

HOUSE RESEARCH | Short Subjects
The Constitution and the Legislature

Deborah A. Dyson

Updated: July 2008

# Special Legislation and Local Approval: An Overview

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; and
- 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 is 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*, July 2008.

HOUSE RESEARCH | Short Subjects

Joel Michael and Nina Manzi August 2008

# Saving for College: 529 Plans and Income Tax Policy

***What are 529 plans?***

529 college savings plans allow parents and others (e.g., grandparents or the student him or herself) to save for college costs in accounts that qualify for special tax treatment. The plans are operated by states. (Higher education institutions may operate pre-paid tuition plans, which are not discussed in this short subject.) Each account has an "owner" (usually the person contributing) and a "beneficiary" (the individual whose education costs will be paid). The owner retains ownership and control of the account and can change the beneficiary. Under federal law, investment of the accounts must be done by the state or the investment company it contracts with to operate its plan, but account owners can choose from among state plans offering an array of investment options and have limited authority to transfer funds (once per year) among plans. Thus, they indirectly have some investment control.

***Do income or contribution limits apply to the plans?***

Unlike most other tax incentives and aid programs for higher education, no income limits apply to 529 plans. Even the highest income families qualify to use them. Contributions must be made in cash. Each state plan sets its contribution limit, but federal law limits this to the amount necessary to provide for the qualifying higher education expenses of the beneficiary. Most states have set this limit higher than $250,000.

***What tax benefits are available for 529 plans?***

Investment income on 529 accounts is exempt from both federal and Minnesota income taxes, if the income is used for qualifying higher education expenses. Qualifying expenses include tuition, fees, room and board, books, and some other education expenses. Investment income on the accounts that is used for nonqualifying purposes is taxed as ordinary income, plus a 10-percent penalty. 529 plans also provide special estate and gift tax benefits.

***Does Minnesota have a 529 plan?***

Yes, 1997 legislation authorized the Minnesota College Savings Plan, and the plan began operations in 2001. TIAA-CREF, a large national financial institution, provides administration and investment management services for the plan. As of the end of 2007, the Minnesota plan had over $650 million in assets and about 54,000 accounts or contracts. At the end of 2007 for the entire nation, total 529 plan assets were about $130 billion for about 10.5 million accounts.

***Can a Minnesotan participate in other state plans?***

Yes, most state plans allow nonresidents to participate, although special preferences may be provided for residents. The federal and Minnesota tax benefits apply equally to investments in other state plans. Although precise evidence is not available, it appears that Minnesota residents have invested more money in other states' 529 plans than in the Minnesota College Savings Plan.

***Who participates in 529 plans?***

Available evidence suggests that most 529 plan assets are held by families in the top income groups. The table below shows the distribution of 529 plan and Education Savings Account (ESA) assets by income group, based on data from the Federal Reserve's 2004 Survey of Consumer Finance. It shows that over 67 percent of these assets are held by the top population decile (the 10 percent of the population with the highest incomes) and over 80 percent by the top quintile.

**529 Plan and ESA Assets by Income of Account Owners**
(amounts in 2004 dollars)

| Income category | Median income* | 529 plan and ESA assets (000) | % of total | % of households with assets |
|---|---|---|---|---|
| 1st quintile (0 – 20%)** | $11,296 | $178,456 | 0.2% | 0.0% |
| 2nd quintile (20% – 40%)** | 25,672 | 196,625 | 0.2% | 0.1% |
| 3rd quintile (40% – 60%)** | 43,129 | 2,963,328 | 3.4% | 1.5% |
| 4th quintile (60% – 80%) | 67,774 | 11,416,287 | 13.2% | 3.0% |
| 9th decile (80% – 90%) | 104,741 | 13,707,740 | 15.8% | 6.0% |
| Top decile (90% – 100%) | 184,838 | 58,192,663 | 67.2% | 10.0% |
| **Total** | **$43,129** | **$86,655,099** | **100%** | **2.5%** |

* Median income of all households in income group, not just those with assets.

** Based on ten or fewer respondents with 529 plan or ESA assets; may not be reliable as to those amounts.

Source: House Research calculations using Federal Reserve Board, *Survey of Consumer Finance* data (2004).

***Do other states provide additional state tax benefits for 529 plans?***

Unlike Minnesota, most states with income taxes provide deductions or credits for contributions to 529 plans. As of June 2008, 32 states and the District of Columbia allowed tax deductions and two states (Indiana and Vermont), credits for 529 plan contributions. (Only ten states with income taxes do not provide 529 plan deductions or credits.) Most of the deductions are limited to contributions to the state's plan, but three states provide deductions for contributions to any state plan. Most of the deductions and both credits are subject to dollar caps, but 13 states do not limit the amount of their deductions.

***Does Minnesota provide other incentives for participation?***

Yes, Minnesota matches contributions to its plan for families with incomes up to $80,000. The maximum annual match is $400. The rate of the match varies with income; a 15-percent rate applies for families with incomes up to $50,000 and a 10-percent rate for those with incomes from $50,000 to $80,000. The state retains ownership of the match amounts and they may only be used for qualifying education expenses. The Minnesota match offers financial benefits comparable to most state tax deductions for qualifying families, but few states impose income limits on their tax benefits. Matching grants are not subject to federal tax, while state tax deductions or credits reduce the federal itemized deduction for state income taxes, diluting their benefits to many recipients by 10 percent to 35 percent. Seven other states also provide matching grants and two operate pilot grant programs; most only provide grants to lower-income families.

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057 or Nina Manzi at 651-296-5204. Also see the House Research publication *529 Plans and Income Tax Policy: The Minnesota College Savings Plan*, June 2008.

# HOUSE RESEARCH | Short Subjects

Kathy Novak and Nina Manzi

Updated: August 2008

## 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 2008 forecast provides the revenue and expenditure projections that the governor will use in developing the budget for the fiscal year 2010-2011 biennium. The November 2008 forecast also tells if the state is on track to finish the fiscal year 2008-2009 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 2009 forecast provides the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2010-2011 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 2009 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 2009 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2010-2011 budget during the 2010 legislative session. The legislature will use the projections in the February 2010 forecast to ensure that the fiscal year 2010-2011 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 all these priorities have been met, the remaining surplus is reported in the forecast as a "positive unrestricted budgetary general fund balance." As of the February 2008 forecast, all the statutory priorities have been met.

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.

**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: Executive Branch Power to Reduce Spending to Avoid a Deficit,* March 2008.

**Pat Dalton** **Updated: August 2008**

# Levy Limits

***General levy limits are imposed for taxes payable in 2009–2011***

The general levy limits under Minnesota Statutes, sections 275.70 to 275.74, restrict the amount of property taxes cities with a population of 2,500 or more and all counties may impose for general fund expenditures. Levy limits were reenacted during the 2008 legislative session and are in effect for taxes payable in 2009 through 2011.

***Levy limits are intended to ensure that state aid reduces property taxes and limits the growth rate of property taxes***

Levy limits are adopted to keep the growth in property taxes low and to help ensure that cities and counties use increased state aid payments to reduce property taxes and not for higher local spending. Because of this, general purpose state aids are included in calculating the limit. When a local government's state aid increases, its maximum allowed levy decreases. Conversely, if a local government's aid decreases, its allowed levy increases. If a local government receives no state aid, the limit applies only to its property tax levy.

Although the purpose of levy limits is to limit growth in property taxes, some opponents argue that they may actually increase taxes by encouraging cities and counties to levy up to the maximum allowed.

***Levy limits have expired several times and been reenacted***

In recent years, the legislature has generally imposed levy limits as part of property tax reforms, or when state aid reductions may have led to higher property taxes. They were re-imposed for Pay 2009–2011 to limit rising property taxes and ensure that aid increases are passed on as property tax reductions. The table shows the years in which levy limits were imposed.

**Chronology of Levy Limits**

| **Taxes payable years** | **Limits Apply?** | **Instigating Event** |
|---|---|---|
| 1972–1992 | Yes | Enactment of 1971 property tax reform |
| 1993–1997 | No | Enactment of Truth-in-Taxation notices as a replacement |
| 1998–2000 | Yes | "Compression" of class rates |
| 2001 | No | Allowed to expire |
| 2002–2003 | Yes | 2001 property tax reform |
| 2004 | Yes | 2003 and 2004 aid reductions |
| 2005–2008 | No | Allowed to expire |
| 2009–2011 | Yes | Previous county and city levy increases |

***State aids are used to calculate limits***

As noted above, state general-purpose aids are used to calculate levy limits. The aids included in the levy limit base are (1) taconite aid; (2) county program aid, for counties only; and (3) local government aid (LGA), for cities only. The combination of levy plus aid is known as the levy limit base.

***The allowed growth in the levy limit base for Pay 2009–2011 is less than usual***

In recent history, the levy limit base has usually been adjusted for inflation, new households, and new commercial and industrial property. For Pay 2009–2011, stricter limits were imposed. A local government's levy limit base (levy plus aids) is increased for growth for the three factors but limited as follows:

- The rate of inflation, as measured by the implicit price deflator (IPD) for state and local government purchases, *but only to a maximum of 3.9 percent*
- *Only one-half* of the percent growth number of households in the local jurisdiction, as estimated by the state demographer or the Metropolitan Council, rather than the usual 100 percent of the growth rate
- One-half of the increase in the total market value in the jurisdiction due to new commercial/industrial development

***Local governments may levy "outside of limits" for certain purposes***

The levy limits do not apply to "special levies." Special levies can be imposed for whatever amount the city or county needs outside of levy limits for specified purposes. For taxes payable in 2009 these purposes include:

- debt for capital purchases and projects;
- state and federal required matching grants;
- preparation for and recovery from natural disasters;
- certain abatements;
- increases in public employee retirement association (PERA) rates after June 30, 2001;
- required jail operation costs;
- operation of lake improvement districts;
- repayment of a state or federal loan related to highway or capital projects; and
- for an animal humane society.

For Pay 2009–2011 the special levy for pension plan rates was expanded to all local government pension plans and five new special levies were added, which include:

- to cover increased costs related to reductions in federal health and human service program grants;
- to cover city costs in cities with high foreclosure rates;
- for Minneapolis to cover unreimbursed costs related to the I-35W bridge collapse;
- for salaries and benefits for police, fire, and sheriff personnel; and
- to recoup any LGA or county program aid losses *if* the governor unallots moneys from these programs due to a future budget crisis.

***Local governments may go to voters for authority to exceed limits***

When levy limits are in effect, a local government may certify a levy higher than its levy limit *if* approved by the voters at a referendum. A vote to exceed the limit may be for any amount, and the tax is spread on tax capacity. Unless approved by a referendum, the final levy may not exceed the limited amount plus the amounts levied for authorized special levies.

**For more information:** Contact legislative analyst Pat Dalton at 651-296-7434. Statutes governing levy limits are Minnesota Statutes, sections 275.70 to 275.74.

**Kathy Novak**

**August 2008**

# Election of University of Minnesota Regents

Regents are elected by the legislature to govern the University of Minnesota. In 2005 and again in 2007, the legislature changed the process for nominating regent candidates. The 2005 changes included a role for the governor and established a joint committee of the legislature. The 2007 Legislature eliminated the governor's role in the regent election process and somewhat modified the composition and responsibilities of the joint committee. This short subject describes the legal requirements for recruiting, reviewing, recommending, nominating, and electing regents and highlights the changes that have been made to this process.

***The Minnesota Constitution provides for regent elections***

The Minnesota Constitution requires that 12 regents be elected by a joint convention of the Minnesota Legislature to staggered six-year terms to govern the University of Minnesota. One-third of the Board of Regents is elected each odd-numbered year at a joint convention of the legislature. Minn. Const., art. XIII, § 3, and University of Minnesota Charter §§ 4 and 5.

***The board represents specific areas and includes one student***

Minnesota law specifies that eight of the 12 regents must reside in Minnesota's congressional districts, one in each district. The four remaining regents are elected from the state at-large. Minnesota law also requires one of the four at-large regents to be a University of Minnesota student at the time of the election. Minn. Stat. §§ 137.023 and 137.024.

***Minnesota law requires an advisory council to recruit and screen regent candidates***

The regent candidate advisory council is established in law to identify, recruit, and recommend qualified candidates. The council has 24 members, including two student members, appointed by the House of Representatives and the Senate to staggered terms. Student members serve two-year terms. All others serve six-year terms. The council screens and recommends regent candidates to a joint committee of the legislature. Minn. Stat. § 137.0245, subd. 2.

The council must develop selection criteria for recruiting regent candidates. Beginning in 2005, diversity became an explicit part of the criteria, including geography, gender, race, occupation, and experience. The council must identify the membership needs of the board, including the skills and characteristics necessary to govern the university and must develop criteria to ensure membership diversity. The council's selection criteria must not include a limit on the number of terms served by an individual regent. Minn. Stat. § 137.0245, subd. 3.

***The advisory council recommends regent candidates to a joint legislative committee***

The regent candidate advisory council must make recommendations to the joint legislative committee by January 15 of each odd-numbered year. The council must recommend two to four candidates for each regent to be elected and must submit, with the recommendations, a report that identifies the membership needs of the board.

The 2007 changes to the selection process reversed the 2005 changes directing the council to make candidate recommendations to the governor, who then submitted a slate of candidates to the joint committee. Minn. Stat. § 137.0245, subd. 4.

***The joint legislative committee receives the council recommendations and may nominate other candidates***

The joint committee was first established in law by the 2005 Legislature to consider the governor's slate of regent candidates. Prior to 2005, joint legislative rules governed the makeup and duties of the joint committee. Temporary Joint Rules of the House and Senate 4.01. Under the 2007 statutory changes, the joint committee consists of the members of the higher education budget and policy divisions of the Senate and the House. The Senate and House committee chairs serve as cochairs of the joint committee.

The joint committee must meet by February 28 of each odd-numbered year, or on a date set by concurrent resolution, to consider the regent nominees. A committee quorum exists when a majority of the House members and majority of the Senate members are present at the joint committee meeting.

Under the 2007 changes, the joint committee may nominate and consider a candidate who is not recommended by the advisory council. To be considered, the nominee must be supported by at least five members of the joint committee—two from the Senate and three from the House.

The 2007 changes also require the joint committee to have two meetings, approximately a week apart. At the first meeting, the committee must interview and nominate candidates for consideration. At the second meeting, the joint committee votes on candidates to recommend. Minn. Stat. § 137.0246.

***The joint committee recommends candidates to the joint convention***

For each vacancy on the Board of Regents, the joint committee may recommend only one candidate to the joint convention of the Senate and the House. A majority of the House members and a majority of the Senate members on the joint committee must support a candidate for that candidate to be recommended to the joint convention. In making recommendations, the law requires the committee to consider the needs of the board, and the gender, racial, and ethnic balance of the board. Minn. Stat. § 137.0246.

***A joint convention of the Senate and the House elects regents***

The joint rules of the Senate and House provide for the election of the regents at a joint convention of the legislative bodies. The rules require the joint committee to report the names of a person recommended for each seat. The person is considered to be nominated for a regent position. Members of the legislature are authorized to submit additional nominations. The candidate for a regent vacancy who receives a majority of the votes cast is declared the winner. Temporary Joint Rules of the 85th session, 4.02.

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

**HOUSE RESEARCH** | **Short Subjects**

**Nina Manzi**

**Updated: August 2008**

# 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 for tax year 2009:

- **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.**
- **Fines and penalties allowed as deductions from federal taxable income.**

***What subtractions does Minnesota allow from taxable income?***

Minnesota allows the following *subtractions* from federal taxable income for tax year 2009. The estimated cost of most subtractions is taken from the Department of Revenue's *Tax Expenditure Budget for 2008-2011* and from estimates made during the 2008 session. Revenue estimates made during the 2009 legislative session will differ from the *Tax Expenditure Budget* because they will be based on a more recent economic forecast, and they may take into account behavioral changes likely to result from proposed changes in the law.

- **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 received by residents:
    - U.S. bond interest
    - Railroad retirement benefits
    - On-reservation earnings of enrolled tribal members
- **K-12 dependent education expenses** ($18.8 million in fiscal year 2010). 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, including training** ($4.43 million in fiscal year 2010).
- **Compensation for most military service in Minnesota** ($3.5 million in fiscal year 2010). Allowed for state active service, federally funded state active service (generally floods, other disasters, and airport security), active service in the full-time military by Minnesota residents, and training pay.
- **50 percent of charitable contributions in excess of $500** ($8.3 million in fiscal year 2010). 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** ($0.7 million in fiscal year 2010). 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** ($4.8 million in fiscal year 2010). 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** (less than $50,000 in fiscal year 2010). Allowed for up to $10,000 of expenses related to organ donation by the taxpayer or a dependent, including lost wages.
- **Gain on sale of farm property for insolvent taxpayers** (less than $50,000 in fiscal year 2010). 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.
- **National service education awards** ($110,000 in fiscal year 2010). Allowed for scholarships received for Americorps service.

**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 2007; and *Minnesota's Elderly Exclusion* (web only) at www.house.mn/hrd/issinfo/tx_inc.htm.

HOUSE RESEARCH | Short Subjects

Mark Shepard

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# Rulemaking: Review of Adopted Rules

All three branches of state government have authority to review administrative rules. The legislature also has established processes under which a person can petition an agency for adoption, amendment, or repeal of a rule, or can petition to stop improper enforcement of a policy that an agency has not adopted as a rule.

***Executive review***

An agency that adopts a rule may amend or repeal the rule. An amendment or repeal is itself considered a "rule" and can be done only after following the usual rulemaking procedures. The governor may veto a proposed rule, but cannot veto or otherwise change an adopted rule, unless the agency follows the rulemaking process.

***Legislative review***

**Amendment or repeal.** The legislature can pass a bill repealing or amending a rule, or changing the permissible scope of the rule. If the legislature removes the statutory authority for rulemaking, rules adopted under that authority are automatically repealed. Minn. Stat. § 14.05, subd. 1.

**Investigation and objection.** The legislature has authorized the Legislative Coordinating Commission (LCC) to investigate complaints about rules. Upon written request of two or more LCC members, or any five legislators, the LCC must review a rule, either by holding LCC meetings or by establishing another group to review the rules. Minn. Stat. § 3.305, subd. 8.

The LCC or the House or Senate governmental operations committees may also formally object to rules. An objection shifts the burden of proof to the agency to show that the rule is valid if the rule is challenged in court. Minn. Stat. § 3.842, subd. 4a.

**Delayed effect.** The House and Senate standing committees with jurisdiction over the subject mater of a rule may vote to delay the effect of a proposed rule until the legislature adjourns the annual legislative session that begins after the vote of the committees. Minn. Stat. § 14.126.

***Judicial review***

An agency rule may be challenged in court. The court must declare a rule invalid if it finds the rule:

- is unconstitutional;
- exceeds the statutory authority; or
- was adopted without complying with statutory requirements.

Minn. Stat. § 14.45.

***Local government petitions for amending or repealing a rule***

A city, county, or sanitary district may petition an agency to amend or repeal a rule. A petition must show that since the rule was adopted, there is significant new evidence relating to the need for or reasonableness of the rule, or a less costly or intrusive method of achieving the purpose of the rule. If an agency does not take the action requested by a petition, an administrative law judge (ALJ) holds a hearing on the continued need for and reasonableness of the rule. If the agency does not demonstrate the continued need for and reasonableness of the rule, the rule does not have the force of law after 90 days. An agency can amend the rule so this does not happen. Minn. Stat. § 14.091.

***Other petitions for changes in rules***

Any person may petition an agency for adoption, amendment, or repeal of a rule. An agency receiving such a petition must respond within 60 days, giving reasons for its response. However, unlike a petition from a unit of local government, there is no hearing process or other remedy if the agency decides not to take the requested action. Minn. Stat. § 14.09.

***Petitions alleging improper enforcement of a policy***

Any person may petition an ALJ, alleging that an agency is improperly enforcing a policy without going through rulemaking. If the ALJ determines that the agency is improperly enforcing a policy as if it were a duly adopted rule, the ALJ must direct the agency to cease this enforcement. However, when an agency enforces a law or rule by applying the law or rule to specific facts on a case-by-case basis, this does not constitute improper rulemaking. Minn. Stat. § 14.381.

***Temporary exemptions from rules***

If the cost of complying with an agency's rule in the first year after the rule takes effect will exceed $25,000 for a business with less than 50 full-time employees or for a city with less than ten full-time employees, the business or city may file a statement with the agency claiming an exemption from the rule. Upon filing of a statement, the rule does not apply to that business or city until the rule is approved by a subsequent law. There are some exceptions. For example, a business or city cannot claim an exemption from a rule adopted because of a federal mandate. The law allowing for exemptions applies only to rules adopted after July 1, 2005. Minn. Stat. § 14.127.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051. Also see the publications *Rulemaking: Process for Adopting Rules*, August 2008, and *Rulemaking: Expedited Process and Exemptions*, August 2008.



House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

HOUSE RESEARCH | Short Subjects

Mark Shepard Updated: August 2008

# Rulemaking: Expedited Process and Exemptions

The legislature sometimes authorizes state agencies to adopt administrative rules without following the usual rulemaking procedures. This is done by allowing agencies to use an expedited process or by exempting certain rules from rulemaking.

***Expedited rulemaking process***

The legislature has created an expedited process for adopting rules. An agency may use this process *only* when specifically authorized by law. Under the expedited process, an agency publishes notice of its proposed rule in the State Register and mails notices to those who have requested notice. The agency must then allow at least 30 days for comment. At the end of the comment period, and after an administrative law judge approves the form and legality, the agency may adopt the rule. Unlike the customary rulemaking process, there is no opportunity for public hearing under the expedited process, unless the legislature specifically provides for this opportunity. Minn. Stat. § 14.389.

There is a separate expedited process for repealing obsolete rules. Minn. Stat. § 14.3895. This process may be used to repeal rules that an agency identifies in a required annual report on obsolete rules.

***Specific exemptions***

The legislature has enacted numerous laws providing that specific agency policies that come within the definition of a "rule" may be adopted without complying with the usual rulemaking procedures. But these laws often require an agency to follow certain minimal requirements even if the rules are exempt from the usual rulemaking procedures. These requirements are as follows:

- The Revisor of Statutes must approve the form of the rule
- The Office of Administrative Hearings must approve the rule's legality
- A copy of the rule must be published in the State Register

These so-called exempt rules are effective only for two years. Minn. Stat. § 14.386.

Sometimes the legislature provides that the two-year effective period and the minimal procedural requirements specified above do not apply to a set of rules.

***"Good cause" exemptions***

The legislature has provided limited circumstances under which an agency may omit rulemaking procedures. This can be done only if rulemaking procedures are unnecessary, impracticable, or contrary to the public interest, and if the rule:

(1) addresses a serious and immediate threat to public health, safety, or welfare;
(2) complies with a court order or federal law in a manner that does not allow for compliance with rulemaking procedures;

(3) incorporates changes in law when no interpretation of law is required; or

(4) makes changes that do no alter the meaning or effect of a rule.

An agency using the good cause exemption must give notice of its proposed rule, including an explanation of why use of the good cause exemption is justified. The Office of Administrative Hearings reviews the legality of the proposed rules, including the justification for use of the good cause exemption.

Occasionally, the legislature specifically authorizes an agency to adopt rules under the good cause exemption. This sometimes happens when the legislature requires an agency to change its rules in a specified manner and the agency has no discretion.

Rules adopted under clauses (1) and (2) are effective only for two years.

Minn. Stat. §14.388.

***Agency statements that are not "rules"***

The legislature has exempted some agency statements from the definition of "rule." The usual rulemaking process does not apply to these statements. Examples include provisions governing internal management of agencies, certain rules of the commissioner of corrections, and revenue notices and tax information bulletins issued by the commissioner of revenue.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051. Also see the House Research publications *Rulemaking: Process for Adopting Rules,* August 2008, and *Rulemaking: Review of Adopted Rules*, August 2008.

HOUSE RESEARCH | Short Subjects

Mark Shepard

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# Rulemaking: Process for Adopting Rules

State agencies must follow certain procedures when they adopt administrative rules. These procedures are contained in the Administrative Procedure Act (often known as the APA) in Minnesota Statutes, chapter 14. For a more detailed description of these procedures, see "Rulemaking in Minnesota: A Guide" on the Revisor of Statutes web site (www.revisor.leg.state.mn.us).

***An agency must follow required procedures when adopting a "rule"***

A "rule" is an agency statement of general applicability and future effect, made to implement a law. In most cases an agency must follow APA rulemaking procedures when it issues a statement that comes within the definition of a "rule." Courts may invalidate agency attempts to set policy without following rulemaking procedures.

***An agency must take certain actions before formally proposing rules***

**Rulemaking docket:** An agency must maintain a rulemaking docket. This docket must contain information on rules that the agency is thinking about proposing and on rules that are in the middle of the rulemaking process. Minn. Stat. § 14.366.

**Solicitation of comments:** An agency must solicit comments from the public on the subject matter of the possible rules at least 60 days before publishing a notice of proposed rules. Minn. Stat. § 14.101.

**Statement of need and reasonableness:** An agency must prepare a statement of the need for and reasonableness of the proposed rules. The statement must be available to the public. The statement must contain a summary of evidence and arguments that the agency intends to use to support the proposed rules. The statement must also:

(1) determine if there are less costly or less intrusive methods for achieving the purpose of the proposed rule;

(2) describe alternative methods for achieving the purposes of the proposed rule that were seriously considered and give reasons why these alternatives were rejected; and

(3) assess the probable costs of complying with the proposed rule and the costs or consequences of not adopting the proposed rule.

Minn. Stat. §§ 14.131 and 14.23.

***An agency must give notice of proposed rules and provide opportunity for a public hearing***

**Notice:** An agency must publish notice of proposed rules in the State Register. It must mail this notice to people who have requested to be notified and must make other reasonable efforts to notify people who may be significantly affected by the proposed rules. Minn. Stat. §§ 14.14, subd. 1a, and 14.22.

**Public hearing:** An agency must conduct a public hearing on proposed rules if 25 or more people submit a written request for a hearing. Most agency rules are adopted without a public hearing. Minn. Stat. § 14.25.

If no public hearing is required, the agency presents its own evidence into the record and accepts material from the public. If a public hearing is held, it is conducted by an independent administrative law judge (ALJ). At the hearing, the agency must make an affirmative presentation demonstrating the need for and reasonableness of the proposed rules. The public may testify and may question agency representatives. Minn. Stat. § 14.14.

***An agency must determine the cost of the proposed rules on small businesses and cities***

If the cost of complying with an agency's rule in the first year after the rule takes effect will exceed $25,000 for a business with less than 50 full-time employees or for a city with less than ten full-time employees, the business or city may file a statement with the agency claiming an exemption from the rule. Upon filing of a statement, the rule does not apply to that business or city until the rule is approved by a subsequent law. There are some exceptions to this provision. Minn. Stat. § 14.127.

***An ALJ reviews the proposed rules***

If the ALJ determines that the agency has not met all of the legal and procedural requirements, the rules are submitted to the chief ALJ. If the chief supports the ALJ, the agency may not adopt the rule until the defects are corrected. Once the ALJ or the chief ALJ approves the rules, the agency may submit them to the governor and take other procedural steps necessary for final adoption.

If the ALJ and the chief ALJ determine that the agency has not established the need for or reasonableness of the rules, the rules are submitted to the Legislative Coordinating Commission (LCC) and to the House and Senate governmental operations committees for comment. After seeking these comments, an agency may adopt the rules. Minn. Stat. §§ 14.15 and 14.26.

***The governor may veto proposed rules***

The governor may veto all or a severable portion of a proposed administrative rule at the end of the rulemaking process, before the rule takes effect. To veto a rule, the governor must submit notice of the veto to the State Register within 14 days of receiving a copy of the rule from the secretary of state. Minn. Stat. § 14.05, subd. 6.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051. Also see the House Research publications *Rulemaking: Review of Adopted Rules*, August 2008, and *Rulemaking: Expedited Process and Exemptions*, August 2008.

**Mark Shepard**

**Updated: August 2008**

# Legislative Review of State Employee Collective Bargaining Agreements

***The executive branch negotiates agreements that must be approved by the legislature***

The commissioner of finance negotiates collective bargaining agreements with exclusive representatives of state employees. The law establishes a process for legislative review of these collective bargaining agreements. (Minn. Stat. §§ 3.855, 43A.06, 179A.22.)

The legislative review process has two parts:

- review and possible interim approval by a legislative subcommittee
- ratification by the full legislature

***A legislative subcommittee may give interim approval to agreements***

The law provides for a legislative commission or subcommittee to initially review collective bargaining agreements between the state and exclusive representatives of state employees. The Legislative Coordinating Commission (LCC) has created a Subcommittee on Employee Relations (SER) to review collective bargaining agreements and to carry out other powers and duties dealing with state employee compensation and related matters.

The commissioner of finance must submit a negotiated collective bargaining agreement to the chair of the SER for legislative approval. The agreement must be submitted within five days of the date of approval by the commissioner or the date of approval by the affected state employees, whichever is later.

When the legislature is not in session, the SER may give interim approval to a negotiated collective bargaining agreement, arbitration award, compensation plan, or salary. Failure of the SER to disapprove a collective bargaining agreement within 30 days constitutes approval. Upon interim approval by the SER, the collective bargaining agreement is implemented. (If the legislature is in session when the SER approves a contract, the contract is not implemented until it is ratified by the full legislature.)

***A legislative subcommittee can reject a proposed agreement***

If the SER rejects a collective bargaining agreement when the legislature is not in session, the collective bargaining agreement is not implemented. New negotiations between the commissioner of finance and the exclusive representative could occur. Also, if the SER rejection occurs during a legislative interim, state employees have the right to strike.

***Agreements must be ratified by the full legislature***

The SER submits approved collective bargaining agreements to the entire legislature for ratification. Approval or disapproval by the SER is not binding on the legislature.

When the legislature has approved agreements, it has done so by reference (e.g., "The collective bargaining agreement between the commissioner and the exclusive representative of state employees, approved by the Legislative Coordinating Commission Subcommittee on Employee Relations is ratified."). Legislative ratification of the agreement is the final step in approval of the contract.

There is no statutory authority for the legislature to modify a collective bargaining agreement. If the legislature enacted a law that had the effect of changing the terms of a proposed collective bargaining agreement, it would be difficult to characterize the result as a contract, as it would no longer represent a document voluntarily entered into by the parties.

***The legislature can reject an agreement, either explicitly or by failing to approve it before adjournment***

If the legislature rejects the collective bargaining agreement or adjourns without acting on it, wages or benefit increases provided in the contract must cease to be paid effective upon the rejection of the agreement or adjournment. However, wage or benefit increases previously paid under SER interim approval need not be re-paid.

The statute does not specifically state that the entire contract is void upon legislative rejection or adjournment without action. However, this seems implicit. If the legislature rejects or fails to ratify a collective bargaining agreement, affected state employees and the state could resume negotiations. Also, state employees have the right to strike upon legislative rejection of an agreement or legislative failure to ratify an agreement.

***There is a similar review process for other compensation plans***

The process for legislative review of arbitration awards, compensation plans for nonunionized employees, and specified salaries (e.g., state agency heads) is similar to that for collective bargaining agreements, but some of the details are different. For example, failure of the SER to ratify a compensation plan does not constitute approval. Also, the SER does not have authority to modify a collective bargaining agreement before approving it, while it does have authority to modify a compensation plan for nonunionized employees and specified salary proposals.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051.

**HOUSE RESEARCH** | **Short Subjects**

**Karen Baker, Steve Hinze, and Jim Cleary**

**August 2008**

# Disabled Veteran Homestead Valuation Exclusion

***What is the disabled veteran valuation exclusion?***

This new program enacted in 2008 provides a property tax benefit to qualifying disabled veteran homeowners by reducing the value of their home for property tax purposes by up to $300,000. The homestead must be owned by the veteran, or by the veteran and her/his spouse, in order to qualify.

***What is the benefit?***

Veterans who are permanently and totally (100 percent) disabled are eligible for a valuation exclusion of $300,000; veterans who are not permanently and totally disabled, but who have a disability rating of 70 percent or higher, are eligible for an exclusion of $150,000. The exclusion amount is subtracted from the value of the homestead as determined by the assessor before property taxes are calculated. If the value of the homestead in any year is less than the exclusion amount, the homestead is totally exempt from property taxes for that year.

***How much is the benefit worth?***

As a rule of thumb, the $300,000 exclusion will reduce property taxes by approximately $3,000 each year, while the $150,000 exclusion will reduce property taxes by approximately $1,500 each year. The actual benefit for an individual home will vary based on the value of the property and the local tax rate.

***What are the qualifications?***

To qualify, the veteran must have been honorably discharged from the U.S. armed forces as indicated by U.S. Department of Defense form DD214 or other official military discharge papers, and must be certified by the U.S. Veterans Administration as having a service-connected disability with a disability rating of 70 percent or higher.

***How does a veteran enroll in the program?***

The veteran must file application form CR-DVHE70 or CR-DVHE100 with the county assessor and provide proof of honorable discharge and of disability rating. Veterans who are permanently and totally disabled do not need to reapply each year; other qualifying veterans need to reapply each year, since their disability rating could change from one year to the next.

***When do the benefits begin?***

Applications received prior to July 1 of any year take effect for taxes payable in the following year, unless the homestead is a manufactured home, in which case the benefit takes effect in the same year. For 2008 only, the application deadline was extended to September 1. Veterans who fail to apply in the first year that they are eligible may file in any subsequent year and begin receiving benefits after that.

***How is the tax benefit paid for?***

Excluding all or a portion of the value of the disabled veteran's home from property taxes slightly increases the taxes on other properties (homes, businesses, farms, etc.) in the taxing jurisdictions where the veteran's home is located, meaning that the surrounding properties are providing the property tax benefit to the veteran. There are some state aid programs to taxing jurisdictions that will provide additional aid to jurisdictions with excluded value, so in those cases a portion of the tax benefit is provided from state resources.

***What about special assessments?***

Other charges that might appear on the property tax statement, such as special assessments and various types of fees, are not affected by the valuation exclusion and must continue to be paid in full.

***Are there survivor benefits?***

For a veteran who is permanently and totally disabled, the surviving spouse continues to receive program benefits in the two calendar years following the death of the veteran, if the surviving spouse continues to own and live in the house. There is no survivor benefit for spouses of veterans qualifying at the 70-percent standard. There is also no survivor benefit for spouses of veterans who are not enrolled in the program before the veteran's death.

***How does the exclusion apply to an agricultural homestead?***

For agricultural homesteads, the exclusion applies only to that portion of the property consisting of the house, garage, and surrounding one acre of land.

***Does the market value exclusion affect other property tax relief programs?***

Properties that qualify for the disabled veterans homestead valuation exclusion do not receive the market value homestead credit. Properties that qualify for the disabled veterans homestead valuation exclusion are not eligible to receive the preferential classification (1b) generally available on the first $50,000 of market value on homesteads owned by persons who are blind or disabled. Homeowners receiving the valuation exclusion will continue to be eligible for the property tax refund program, although it is likely that they would qualify for a significantly smaller refund because their property taxes would be so much lower due to the exclusion.

**For more information:** Contact legislative analyst Karen Baker at karen.baker@house.mn, Steve Hinze at steve.hinze@house.mn, or Jim Cleary at jim.cleary@house.mn.

Karen Baker & Nina Manzi September 2008

# Major State Aids and Taxes: An Overview of the 2006 Update

This provides a brief overview of the report *Major State Aids and Taxes: A Comparative Analysis, 2006 Update*, which highlights major aids provided to the local governments and people in Minnesota and lists the major taxes collected. The per capita amounts were calculated using 2006 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**<br>*Aid paid to school districts for all K-12 educational expenses* | 2005/2006 (school year) | **$6,477.9 State**<br>$3,577.9 Metro<br>$2,900.0 Nonmetro | **$1,238 State**<br>$1,268 Metro<br>$1,204 Nonmetro |
| **Human services aid**<br>*State's share of human services aid for various income and medical assistance programs* | 2006 | **$3,628.7 State**<br>$1,933.5 Metro<br>$1,695.2 Nonmetro | **$694 State**<br>$685 Metro<br>$704 Nonmetro |
| **Highway aid**<br>*Distributed to counties, cities, and towns for highway purposes* | 2006 | **$524.2 State**<br>$149.3 Metro<br>$374.9 Nonmetro | **$100 State**<br>$53 Metro<br>$156 Nonmetro |
| **Local government aid**<br>*Provides property tax relief by providing general purpose financial support to cities* | 2006 | **$484.6 State**<br>$173.1 Metro<br>$311.5 Nonmetro | **$93 State**<br>$61 Metro<br>$129 Nonmetro |
| **Disparity reduction aid**<br>*Provides aid to jurisdictions (counties, towns, and school districts) that had inordinately high tax rates in 1988* | 2006 | **$18.3 State**<br>$1.4 Metro<br>$16.9 Nonmetro | **$4 State**<br>– Metro<br>$7 Nonmetro |
| **County program aid**<br>*County general purpose aids: includes former homestead and agricultural credit, county criminal justice aid, family preservation aid, and attached machinery aid* | 2006 | **$205.8 State**<br>$86.1 Metro<br>$119.8 Nonmetro | **$39 State**<br>$31 Metro<br>$50 Nonmetro |
| **Community corrections funding**<br>*Aid that provides a portion of counties' costs for community correctional services* | 2006 | **$78.1 State**<br>$40.1 Metro<br>$38.0 Nonmetro | **$15 State**<br>$14 Metro<br>$16 Nonmetro |
| **Property tax refund** (excludes targeting)<br>*Reimburses homeowners and renters for a portion of property taxes if those taxes exceed a household income threshold* | 2005 (filed in 2006) | **$335.5 State**<br>$231.3 Metro<br>$104.2 Nonmetro | **$64 State**<br>$82 Metro<br>$43 Nonmetro |
| **Targeting**<br>*Additional homeowner property tax refund if property taxes increased a certain percentage threshold over previous year (no income limits)* | 2006 | **$13.6 State**<br>$10.3 Metro<br>$3.3 Nonmetro | **$3 State**<br>$4 Metro<br>$1 Nonmetro |

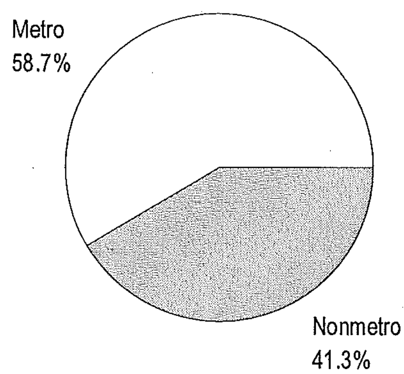
## MAJOR TAXES

| | Year | Amount (millions) | Per capita |
|---|---|---|---|
| **Individual income tax**<br>*Imposed on income of state residents and income derived from state sources of nonresidents* | 2005 (filed in 2006) | **$6,304.1 Total**<br>**$6,042.3 Residents**<br>$4,118.6 Metro<br>$1,923.8 Nonmetro | **$1,155 State**<br>$1,460 Metro<br>$798 Nonmetro |
| **Sales and use tax**<br>*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)* | 2006 | **$4,431.2 (After refunds)**<br>**$3,729.8 Residents**<br>$2,418.1 Metro<br>$1,311.7 Nonmetro | **$713 State**<br>$857 Metro<br>$544 Nonmetro |
| **Motor vehicle sales tax**<br>*Imposed on new and used motor vehicles at the time of sale at the same rate of state sales tax* | 2006 | **$532.2 State**<br>$275.3 Metro<br>$256.9 Nonmetro | **$102 State**<br>$98 Metro<br>$107 Nonmetro |
| **Motor vehicle registration tax**<br>*Imposed annually on vehicles licensed in the state* | 2006 | **$488.5 State**<br>$260.9 Metro<br>$227.7 Nonmetro | **$93 State**<br>$92 Metro<br>$94 Nonmetro |
| **Motor vehicle fuels tax (gas tax)**<br>*Imposed on gasoline, diesel fuel, and other motor fuels used by vehicles and on aviation fuels* | 2006 | **$641.7 State**<br>$301.8 Metro<br>$339.8 Nonmetro | **$123 State**<br>$107 Metro<br>$141 Nonmetro |
| **Corporate franchise (income) tax**<br>*Imposed at a rate of 9.8 percent on the net income of corporations (or alternative minimum tax)* | 2005 | **$696.2 State**<br>$508.2 Metro<br>$188.0 Nonmetro | **$133 State**<br>$180 Metro<br>$78 Nonmetro |
| **State general property tax**<br>*Imposed on commercial/industrial/public utility property and seasonal recreational property* | 2006 | **$655.6 State**<br>$440.3 Metro<br>$215.2 Nonmetro | **$125 State**<br>$156 Metro<br>$89 Nonmetro |

## PROPERTY TAX DATA

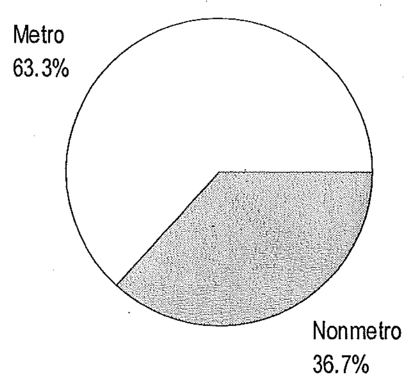
### Market Value

**Total statewide: $464.1 billion**




### Net Property Tax

**Total statewide: $6.6 billion**




**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, 2006 Update* (September 2008) for further details about each aid program and tax and data by county and economic development region.

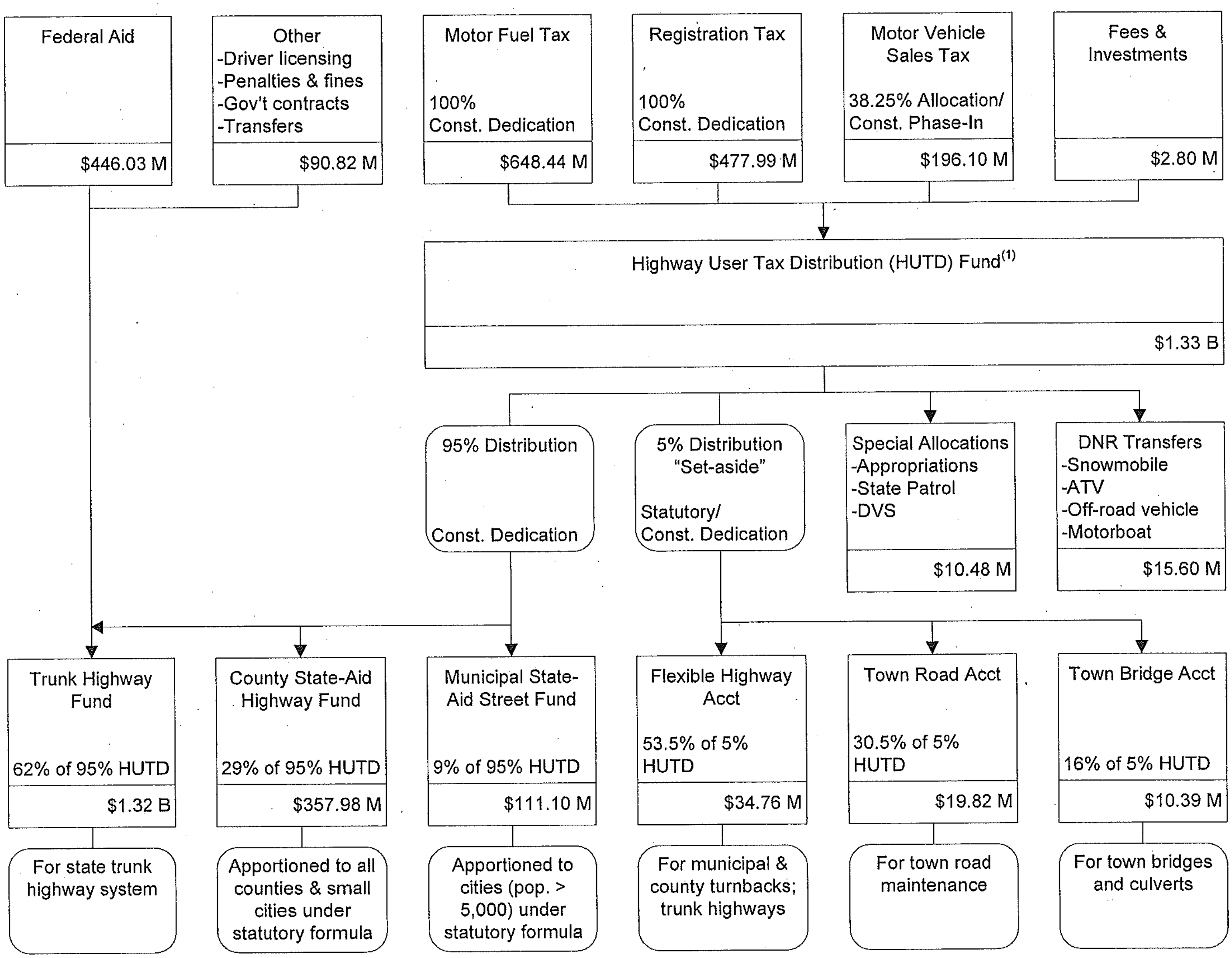
The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

Matt Burress

Updated: September 2008

# Highway Funding Sources and Distribution

The Minnesota Constitution dedicates certain taxes to transportation purposes and establishes a framework for distributing revenue. State statutes further specify allocation formulas and grant requirements. The chart below summarizes Minnesota's highway funding design, with fiscal year 2008 amounts.




**Notes**

(1) Special allocations and DNR transfers take place before the 95% & 5% distributions

***Constitutional framework***

The Minnesota Constitution contains the basic framework for highway funding, establishing three highway user taxes and requiring that the revenue be "used solely for highway purposes." Minn. Const., art. XIV, § 5. It also specifies how the revenue must be distributed to the state and local units of government.

***Sources of highway funding***

The first of three main state funding sources is a tax on motor fuels, imposed at a per-gallon rate. Minn. Stat. §§ 296A.07; 296A.08. For special fuels such as E-85, the rates are based on the energy content of the fuel. Legislation passed in 2008 will phase in an 8.5-cent tax increase, so that starting in fiscal year 2013, the rate for gas and diesel fuel will be 28.5 cents per gallon. A portion of the revenue is attributed to nonhighway use and transferred to DNR accounts. Minn. Stat. § 296A.18.

The second source is a registration tax (also known as tab fees), modified in 2008 and imposed on motor vehicles using the highway system. The registration tax for passenger vehicles is a percentage of the original value of the vehicle. There is a statutory depreciation schedule that reduces the tax owed based on the vehicle's age. Minn. Stat. § 168.013, subd. 1a. Taxes on trucks, buses, and recreational vehicles are based on the vehicle's weight and its age.

Third, a motor vehicle sales tax (MVST) applies to sale of motor vehicles, at the same 6.5-percent rate as the general sales tax. Until recently, MVST revenue was allocated by statute to both transportation and the general fund. A constitutional amendment adopted in the 2006 election will phase in MVST revenue solely to roads and transit. Starting in fiscal year 2012, after the phase-in, MVST will be statutorily allocated 60 percent to roads and 40 percent to transit. Minn. Stat. § 297B.09.

***Distribution of revenue***

State revenue is distributed in two parts. First, a constitutional formula distributes 95 percent of the revenue.

- 62 percent goes to the trunk highway fund for the construction, maintenance, and administration of the state trunk highway system. The trunk highway fund also receives federal aid and funding from other sources.
- 29 percent goes to the county state-aid highway (CSAH) fund to support county state-aid highways. It is allocated among all counties and certain small cities via statutory formulas that include each county's proportion of construction needs, vehicles registered, and lane miles. Minn. Stat. § 162.07.
- 9 percent is for the municipal state-aid street (MSAS) fund for city roads in the state-aid system. It is distributed via a formula of 50 percent construction needs and 50 percent city population. Eligible cities are constitutionally limited to those with a population over 5,000. Minn. Const., art. XIV, § 8.

Second is a 5-percent "set-aside," distributed by statute. Money must go to one of the three foregoing funds, and the distribution cannot be changed more than once every six years. The next change is set to take effect July 1, 2009. Laws 2008, ch. 152, art. 6, § 5. After the change, it will be allocated from the CSAH fund as follows:

- 53.5 percent to a flexible highway account for (1) trunk highways being turned over to cities or counties, (2) metropolitan counties, (3) safety improvements on local roads, and (4) routes of regional significance
- 30.5 percent to an account for town road construction and repair
- 16 percent to a town bridge account for bridge replacement and repair

**HOUSE RESEARCH** | **Short Subjects**

**Lynn Aves & Emily Cleveland**

**Updated: October 2008**

# State Regulation of Health-Related Occupations

***Who regulates health-related occupations in Minnesota?***

At least 47 health-related occupations are regulated by the state. Health-related occupations regulated by the state are overseen by either the Minnesota Department of Health (MDH) or by a health-related licensing board. As of October 2008, there were 17 health-related licensing boards and two divisions in MDH that oversee health-related occupations. Some licensing boards regulate a single occupation, while others regulate a range of related occupations. For example, the Minnesota Board of Optometry only regulates optometrists, while the Minnesota Board of Medical Practice regulates acupuncturists, athletic trainers, osteopaths, physician assistants, physicians, respiratory care practitioners, and traditional midwives. MDH regulates various allied health professionals, such as speech-language pathologists and audiologists; various environmental health professionals, such as lead workers; and unlicensed complementary and alternative health care providers.

***How are health-related occupations regulated?***

Health-related occupations may be regulated in one of several ways. Where necessary and appropriate, statute allows two or more of these methods of regulation to be utilized at the same time. You cannot always rely on the title a provider uses to determine how the provider is regulated. For instance, a registered nurse is actually licensed, not registered. What follows are some methods of occupational regulation.

- *Licensure* is the most stringent form of regulation. Under licensure, a person cannot practice in an occupation unless the person has satisfied predetermined qualifications for practicing and has been recognized by the state as having met those qualifications. Minn. Stat. § 214.001, subd. 3, para. (d). This is also known as "scope of practice protection." A person may demonstrate that the required qualifications have been met by passing a licensing examination, graduating from an accredited educational institution with a relevant degree, or working in the field while under supervision. Example: dentists.
- With *registration*, only registered persons who have met predetermined qualifications for practicing are allowed to use a designated title ("title protection") and are listed on an official roster. Minn. Stat. § 214.001, subd. 3, para. (c). Under a registration system, it is possible for a person to practice in an occupation without being registered, as long as the person does not use any protected titles. Occupations that are licensed generally also prohibit nonlicensed persons from using protected titles. Example: audiologists.
- To obtain *certification*, a person must satisfy the qualification requirements specified in statute or rule. It may be possible for a person

to practice in an occupation without being certified, but other laws may allow only a certified professional to be on-site at a specific program, perform certain functions, or supervise other personnel. Example: food managers.

- Some occupations are not licensed, registered, or certified, but providers are required to conform to a *client bill of rights* and *not engage in prohibited conduct*. A regulatory body has authority to investigate complaints against these providers and take and enforce disciplinary actions against providers for engaging in prohibited conduct or violating the client bill of rights. The regulatory body may revoke or suspend the provider's right to practice. Example: unlicensed mental health practitioners.
- *Criminal and civil penalties* exist to punish or prevent illegal acts by providers. Laws imposing criminal or civil penalties are enforced by consumers or prosecutors.

***How does the legislature decide if a health-related occupation should be regulated?***

No occupation may be regulated by the state unless its regulation is required for the safety and well-being of Minnesotans. Minn. Stat. § 214.001, subd. 2. This standard applies to both health-related occupations and nonhealth-related occupations. When the legislature determines whether an occupation should be regulated, it must consider the following factors:

1. whether the unregulated practice of the occupation may harm the health, safety, and welfare of Minnesotans in a recognizable way;
2. whether practicing the occupation requires special skills or training, and whether the public would benefit from being assured of the person's ability to practice the occupation;
3. whether Minnesotans may be protected more effectively by means other than occupational regulation; and
4. whether the overall cost-effectiveness and economic impact of regulation would be positive for the state.

***What information must the legislature receive regarding proposals to regulate a new occupation or expand regulation of an already-regulated occupation?***

If a bill is introduced in the legislature to regulate a new occupation or to expand regulation of an already-regulated occupation, supporters of the proposal must submit to the legislature evidence supporting the new or expanded regulation. Minn. Stat. § 214.002, subd. 1. The information must be submitted in written form and must be provided to the chairs of the House and Senate committees with jurisdiction over the occupation at issue. The subjects that must be covered in the report are specified in statute. Minn. Stat. § 214.002, subd. 2. Some of them include specifying the harm to the public caused by the unregulated practice of the occupation or continued practice at its current level of regulation; explaining why the proposed level of regulation is being proposed; and discussing how the proposed regulation would impact the supply of providers and the cost of the provider's services.

HOUSE RESEARCH | Short Subjects

Matt Burress Updated: October 2008

# Minnesota Speed Limits

State 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 under certain situations (see Minnesota Statutes, section 169.14).

***Basic requirements and speed limits***

Regulation of speeding is part of Minnesota's statewide traffic laws. Speed limits are set based on the type of roadway and can be adjusted under certain circumstances. The speed limits are: 30 m.p.h. for streets and highways in an urban district; 30 m.p.h. for township roads in a rural residential district; 10 m.p.h. for alleys; 65 or 70 m.p.h. for interstates (depending on whether it is, respectively, within or outside an urbanized area of at least 50,000); 65 m.p.h. on multilane, divided highways with controlled access; and a default of 55 m.p.h. on other roads.

An "urban district" is any segment of street or highway that is built up with structures less than 100 feet apart for a minimum distance of a quarter-mile. Minn. Stat. § 169.011, subd. 90. A "rural residential district" is a segment of a township road with residential houses less than 300 feet apart for a minimum distance of a quarter-mile. Minn. Stat. § 169.14, subd. 2.

The law also 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..." Minn. Stat. § 169.14, subd. 1. These conditions place additional restrictions on the statutory speed limits.

***Adjusted limits in 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; these limits go into effect once signs are posted. Speed zones are established after MnDOT conducts an engineering and traffic investigation that analyzes factors like roadway design, physical characteristics, traffic volume, accident history, and observed speeds. Generally, MnDOT believes the maximum limit should be set near the 85th percentile (the speed at or below which 85 percent of vehicles are traveling).

***Restricted local authority***

Cities, counties, and towns have limited power over setting speed limits, even on their own streets and highways. If requested by a local road authority, MnDOT must perform an engineering and traffic study on a local road. However, MnDOT—not the local authority—determines the safe and reasonable speed limit, as well as whether to establish a speed zone. There are a few exceptions to this general rule.

- If MnDOT has previously established a speed zone for a city street or township road that is at least a quarter-mile long and is within an urban district, the city or town can lower the limit to 30 m.p.h.

- 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.
- In school zones, a local road authority may prescribe a lower limit that is not less than 15 m.p.h. or more than 30 m.p.h. below the surrounding limit. School zones are 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. Minn. Stat. § 169.14, subd. 5a.
- Subject to certain requirements, lower speed limits can also be set on other roadways, including park roads (at not less than 15 m.p.h., or more than 20 m.p.h. below the surrounding limit), on streets that have a bicycle lane (at not less than 25 m.p.h.), and in alleys. Minn. Stat. §§ 160.263, subd. 4; and 169.14, subds. 5c and 5e.

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.

***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 (1) occurs in a work zone or school zone, (2) involves speeds of 20 m.p.h. or more above the posted limit, or (3) occurs when passing a parked emergency vehicle with flashing lights. 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. Minn. Stat. § 169.89, subd. 1. A driver's license will be revoked for at least 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. However, a third petty misdemeanor in a year can be charged as a misdemeanor, and a third misdemeanor in a year can result in license revocation.

***Speeding violations on a driver's record***

A law first enacted in 1986, known as the "Dimler amendment" (after its author, former Representative 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 traveling:

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

The prohibition on recording violations does not apply 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, subd. 6.

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

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Kathy Novak Updated: October 2008

# Tuition Reciprocity Program

The tuition reciprocity program lowers the amount of tuition a student from one state pays to attend a public college or university in another participating state. Minnesota law authorizes the Office of Higher Education (OHE) to enter into reciprocity agreements with other states to reduce tuition for nonresident students. Reciprocity students pay a tuition rate that is less than the nonresident tuition rate, but may be more than the resident tuition rate.

***Who is eligible to participate?***

Minnesota has separate tuition reciprocity agreements with North Dakota, South Dakota, and Wisconsin covering all public postsecondary institutions. Minnesota has limited agreements with Iowa (covering one institution in each state) and Manitoba (covering all Minnesota institutions and five universities and one college in Manitoba).

Students who live in a participating state and enroll in a public undergraduate, graduate, or professional program in another participating state are eligible for tuition reciprocity. Most graduate and professional programs are included in the tuition reciprocity program. For professional programs, the Wisconsin and Minnesota agreement is limited to pharmacy and law professional programs.

Students must first apply to a public college or university in a reciprocity state and then apply for reciprocity to the administering agency in their home state—OHE for Minnesota students. Students have until the last day of the academic term to apply for reciprocity. The reciprocity program has no limit to the number of participating students. A student's reciprocity benefits automatically renew for subsequent academic terms. Any changes to the reciprocity agreements apply to students who first enroll after the effective date of the change.

***What do the agreements cover?***

The reciprocity agreements and annual memorandum specify the terms of participation, including undergraduate, graduate, and professional tuition rates for institutions and programs. The agreements must be approved by postsecondary governing boards—in Minnesota, the Minnesota State Colleges and Universities (MnSCU) Board of Trustees and the University of Minnesota Board of Regents. Most of the agreements exclude fees charged by participating institutions. Only the South Dakota-Minnesota agreement includes both tuition and mandatory fees.

***What tuition rates do students pay?***

For undergraduate students who first enroll in the tuition reciprocity program in the fall of 2008, the most common tuition rate structures are:

- higher of the resident tuition rate at the institution attended or at a comparable institution (or group of institutions) in the student's home state *(Minnesota and Wisconsin agreement; South Dakota and Minnesota agreement for four-year institutions, which also includes fees)*
- the resident rate at the institution attended *(technical colleges in the*

*Wisconsin-Minnesota agreement; North Dakota residents attending Minnesota public institutions)*

- the resident tuition rate at the institution attended plus an adjustment factor *(Minnesota students attending certain four-year North Dakota institutions; South Dakota students attending Minnesota community colleges)*
- the average resident tuition rate at a group of colleges in the student's home state *(Minnesota students attending certain North Dakota four year institutions)*

For enrollments beginning in 2008, the structure of graduate reciprocity tuition rates is similar to each agreement's undergraduate rate structure. Professional programs typically charge the higher of the resident rate in the two states or a rate established by the enrolling institution.

Recent changes to the Wisconsin-Minnesota agreement increased reciprocity tuition rates for new students who attend the University of Minnesota. The state of Wisconsin pays the higher amount as a tuition supplement to the University of Minnesota.

***Does the reciprocity program cost the state?***

The state pays for the reciprocity program through general fund appropriations to public institutions and through specific appropriations to OHE for payments to other states, as required in the Wisconsin and North Dakota agreements.

Minnesota appropriated $2 million each year for fiscal years 2008 and 2009 for reciprocity payments to other states. (The 2008 Legislature reduced the 2009 appropriation to $1.75 million.) In the 2006-2007 biennium, Wisconsin paid $10 million to the general fund for the tuition reciprocity program and Minnesota paid $280,000 to North Dakota. Changes in the Wisconsin-Minnesota agreement will reduce Wisconsin payments beginning in fiscal year 2009. Minnesota has not made a tuition reciprocity payment to Wisconsin since fiscal year 2001.

***How many students participate in the program?***

Students from Minnesota, North Dakota, South Dakota and Wisconsin account for most of the participants in the reciprocity program. In fiscal year 2007, 43,506 students from the four states enrolled in public postsecondary institutions through the reciprocity program. Approximately 95 percent of these students are undergraduates. Minnesota sends more students to each of the other states than it receives from them.

**Fall 2006 Reciprocity Enrollment**

| | *From Minnesota Attending in* | *Attending in Minnesota from* | *Net Outflow of Minnesota Students* |
|---|---|---|---|
| North Dakota | 8,093 | 5,860 | 2,233 |
| South Dakota | 2,295 | 1,926 | 369 |
| Wisconsin | 13,686 | 11,646 | 2,040 |
| Total | 24,074 | 19,432 | 4,642 |

House Research

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

Kathy Novak

Updated: October 2008

# Financial Aid for Higher Education: Minnesota 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 (OHE) administers the state grant program.

***Who is eligible for a state grant?***

Each term, students must apply for a state grant within 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.

A Minnesota resident must meet one of the following residency criteria: have lived in the state for one year without attending a postsecondary institution; be a dependent of a resident; be a graduate of a Minnesota high school, or recipient of a GED, while living in Minnesota and physically attending an eligible institution; be in the military on active service in Minnesota or a spouse or dependent; have relocated to Minnesota due to a declared disaster interrupting postsecondary education; or be a legal refugee 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, including 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 with:

- students responsible for 46 percent of the cost of attendance;
- a deduction for the federal contribution through the Pell Grant; and
- the family's financial share determined by the 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 2008-2009, the tuition maximums are $9,838 for four-year programs and $5,808 for two-year programs. The LME allowance for two- and four-year programs is set at $5,900 per year. The LME allowance is used to calculate the state grant award and is not a separate payment category. Minnesota law requires OHE to use any appropriations above what are needed to fund grants to increase the LME.

Except for the Minnesota GI Bill and private and institutional aid, the state grant is the last contribution to the cost of attendance. The average state grant for the 2006-2007 year was $1,947, an increase of 11 percent over the $1,748 average grant in 2005-2006.

***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 to OHE for the state grant program based on OHE's estimate of what is needed to fully fund projected grant awards. State law allows OHE to carry a balance from the first year of the biennium to the second year and authorizes the transfer of money to and from other financial aid programs. Surplus appropriations must be used to increase the LME.

***Are eligible students entitled to a state grant?***

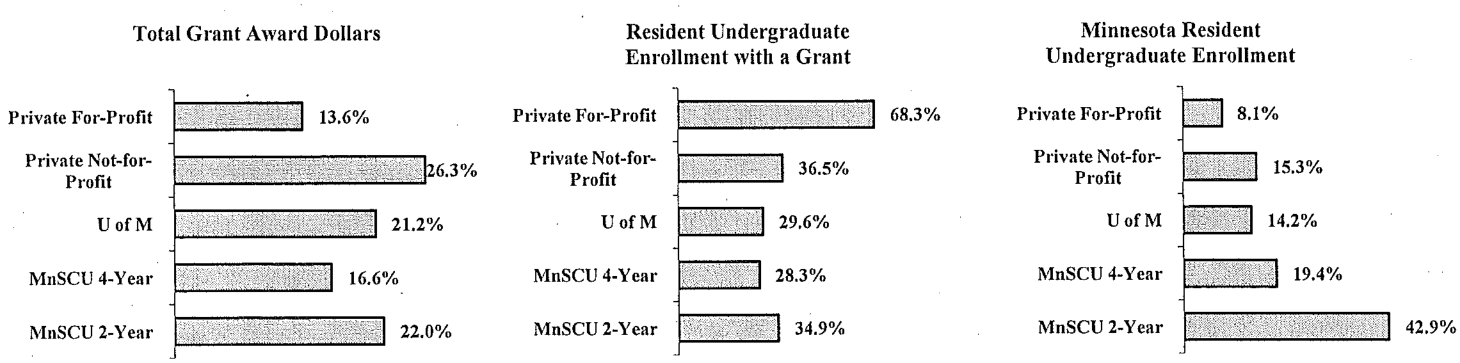
Under state law, the state grant program is not an entitlement. OHE must award grants based on available funding. If funding is insufficient to make full awards, OHE is required, by law, to reduce all grants by adding a surcharge to the family responsibility and increasing the student's responsibility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

***How do grants compare to enrollment at state postsecondary institutions?***

The graph below summarizes participation in the state grant program in fiscal year 2007 and compares it to resident enrollment. In fiscal year 2007, $156 million in state grant awards were distributed to 80,180 recipients. Thirty-six percent of the 233,640 resident undergraduate students who attended participating Minnesota public and private postsecondary institutions received a state grant.

The largest share of undergraduate enrollment is at public two-year colleges (43 percent). The grant award dollars are spread more evenly among the higher education sectors, with 26 percent for private nonprofit institutions, 22 percent at public two-year, 21 percent at the University of Minnesota, 17 percent at state universities, and 14 percent at private for-profit institutions. The share of students who receive a state grant also varies by sector, with two-thirds of the resident students at private for-profit institutions receiving state aid compared to approximately 29 percent of the resident students at public four-year institutions who receive state grants.

**Distribution of State Grants and Minnesota Resident Enrollment by Institution Type**
**Fiscal Year 2007**




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

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# HOUSE RESEARCH | Short Subjects



**Kathy Novak**



**Updated: October 2008**


## Child Care Assistance for Postsecondary Students

The child care grant program is one of the financial aid programs funded by the state and administered by the Minnesota Office of Higher Education (OHE). Its purpose is to reduce the child care costs for higher education students. The availability of child care assistance depends, in part, on the level of funding provided by the legislature.

***Who is eligible for the child care assistance grant?***

To be eligible for a child care grant, a student must:

- be a resident Minnesota undergraduate enrolled at least half-time in a nonsectarian program leading to an undergraduate degree, diploma, or certificate at an eligible institution;
- have one or more children age 12 or under (14 or under if disabled) who receive regular care from a licensed or legal nonlicensed child care provider;
- have had less than four years of full-time postsecondary education;
- meet the income guidelines that provide the maximum grant amount to families with incomes at or below 130 percent of the 2008 federal poverty guidelines adjusted for family size ($17,500 for a two-person family);
- have demonstrated financial need; and
- have not received tuition reciprocity or assistance through the Minnesota Family Investment Program (MFIP).

***Are all postsecondary institutions part of the grant program?***

No, for-profit institutions that do not offer baccalaureate degrees are not eligible to participate. State law limits the child care grant program to Minnesota institutions that are:

- public postsecondary colleges and universities;
- private, baccalaureate degree-granting colleges and universities; and
- nonprofit, degree-granting vocational-technical institutions.

Schools must sign an agreement with OHE to be part of the program.

***What is the size of the grant award?***

The maximum grant amount is set in statute at $2,600 per child for a nine-month grant. A student may also receive a separate summer grant. The actual grant award depends on the availability of appropriations and the student's income, number of children, child care costs, and financial need.

The average child care grant in 2006-2007 was $1,796.

***What are the trends in funding and participation for the child care grant program?***

Appropriations for the 2008-2009 biennium are $6.184 million each year. Student participation peaked in 2006-2007 when 2,832 students received grants. The legislature increased the maximum grant to $2,600 beginning with the 2007-2008 academic year, bringing it back to the level of the 2002-2003 maximum award, when, as part of budget balancing efforts, the legislature reduced the maximum grant award and authorized the transfer of child care appropriations to fully fund the state grant program.

**Trends in Child Care Grant Program**

| Year | Maximum Award | Appropriations* | Number of Students | Average Award |
|---|---|---|---|---|
| 02-03** | $2,600 | $4,710,000 | 932 | $1,146 |
| 03-04 | $2,200 | $4,710,000 | 2,536 | $1,679 |
| 04-05 | $2,200 | $4,710,000 | 2,662 | $1,755 |
| 05-06 | $2,300 | $4,934,000 | 2,592 | $1,836 |
| 06-07 | $2,300 | $4,934,000 | 2,832 | $1,796 |
| 07-08 | $2,600 | $6,184,000 | NA | NA |
| 08-09 | $2,600 | $6,184,000 | NA | NA |

* Except for fiscal years 2008 and 2009, appropriation amounts exclude set-asides for OHE
** $3,610,000 of fiscal year 2003 appropriation transferred to state grant program

***Are postsecondary students eligible for other types of child care assistance?***

Higher education students with children may be eligible for the Basic Sliding Fee (BSF) child care assistance program administered by the Department of Human Services. Students who meet the income and other criteria are eligible, on a space-available basis, in the county where they live.

Students are not required to work to receive BSF assistance but must be enrolled in a course of study approved by the county. Students who need child care assistance for both employment and school must work at least ten hours per week at a wage at least equal to the minimum wage.

Typically, more families are eligible for BSF assistance than can be served with the state and federal appropriations. Students tend to be a lower priority for assistance than working families.

The two child care assistance programs are funded by different legislative committees. The committee with responsibility for higher education finance appropriates money for the grant program administered by OHE but does not fund the BSF program. BSF received a general fund appropriation of $45 million for fiscal year 2009.

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

Anita Neumann

Updated: October 2008

# The Dislocated Worker Program

***What is the Dislocated Worker Program?***

The Dislocated Worker Program provides assistance to some individuals who are displaced from their employment or source of support and require assistance in returning to or entering the workforce (Minn. Stat. § 116L.17).

***Who is eligible for assistance?***

Several kinds of workers are eligible for assistance under the program. They include those who:

- are separated or have received a notice of permanent separation from their employment, are eligible for or have exhausted their unemployment benefits, and are unlikely to return to their previous industry or occupation;
- are terminated or have been notified of impending termination as part of a plant closing or other large layoff;
- have been long-term unemployed and have limited opportunities for similar reemployment in the area where they live;
- have been self-employed (including as farmers or ranchers) and are unemployed as a result of economic conditions or natural disasters;
- have been permanently separated from their job in a restaurant, bar, or lawful gambling organization from October 1, 2007, to October 1, 2009, as a result of a state smoking ban;
- are veterans discharged or released from active duty under honorable conditions and are unemployed or earning less than what they could verifiably earn; or
- are displaced homemakers, meaning they have spent a number of years providing homemaking service while dependent on another person and that person is no longer providing support as a result of the other person's disability or death, or because of a divorce. "Displaced homemaker" can also include a person who previously was supported by public assistance because of the presence of a dependent in the household who is no longer present.

***What kind of assistance is available?***

The program provides basic employment services such as job counseling, testing, skills assessment, job search, and placement assistance. It provides money for training, including classroom training, on-the-job training, skills training, and basic education. It offers support services, including temporary help with expenses such as emergency housing assistance and rent, health care, transportation, child care, work-related tools and clothing, and similar costs that may need to be covered while a person is in training.

***How is the money distributed?***

Funds are appropriated to the Job Skills Partnership Board and then allocated to workforce service areas (there are 18 such areas in Minnesota, established by federal law) or other eligible organizations, which may include labor organizations, business organizations, state or local government agencies, or nonprofit agencies. These areas and organizations often in turn contract with individual service providers to deliver services to individuals.

***Where does the money come from?***

Employers pay a special assessment along with their unemployment insurance taxes that goes into a separate fund called the Workforce Development Fund.

Not all the money in the Workforce Development Fund goes to fund the Dislocated Worker Program. The legislature appropriates some of the money in the fund to support other employment and training programs. Whatever money remains after these appropriations are made is available for the Dislocated Worker Program. Under certain circumstances, if there is more money in the fund than is necessary to meet the needs of dislocated workers, the Job Skills Partnership Board can use the extra money for other workforce training programs.

In addition to the state money, there are federal funds appropriated for the federal Dislocated Worker Program, which is similar to the state program.

**For more information:** Contact legislative analyst Anita Neumann at anita.neumann@house.mn.

HOUSE RESEARCH | Short Subjects

Patrick McCormack

October 2008

# Indian Gambling in Minnesota

There are 18 tribal casinos in Minnesota operating under a combination of state law, tribal ordinance, and tribal-state compacts.

***The federal Indian Gaming Regulatory Act authorizes gambling on Indian land***

Nationally, Indian gambling is authorized by the federal Indian Gaming Regulatory Act (IGRA). This law generally allows Indian tribes in any state to conduct on Indian land those types of gambling that the state allows for non-Indians. IGRA divides all gambling on Indian land into one of three classes:

- **Class I gambling**, which includes traditional Indian ceremonial and social games, is controlled exclusively by the tribes.

- **Class II gambling** consists of bingo, keno, pull-tabs, punchboards, and nonbanking card games (games where players play against each other rather than against the house). Class II gambling is governed by a tribal ordinance that must meet federal guidelines and be approved by the National Indian Gaming Commission.

- **Class III gambling** consists of common casino games such as roulette, craps, chemin de fer, baccarat, and banking card games such as blackjack. The term also includes all mechanical or electronic gambling machines such as slot machines and video poker devices. Class III gambling is conducted under a compact that each tribe negotiates with the government of the state in which it is located. Compacts can specify which party has civil and criminal jurisdiction over gambling enforcement. The compacts can apply those state laws to class III gambling that each party believes necessary for regulation.

IGRA defines Indian land as land that is either:

- part of a federally recognized Indian reservation, or
- off of a reservation but held in trust for an Indian tribe by the federal government, or under the jurisdiction of an Indian governing body.

As this definition points out, it is not necessary for land to be actually part of a reservation for gambling to be conducted on it. In theory, an Indian tribe could buy land anywhere in a state and operate a casino on it by having it declared Indian trust land by the U.S. Secretary of the Interior. Such a designation of Indian trust land for gambling purposes also requires the concurrence of the governor of the state.

***A state's authority to control gambling is limited***

A state cannot prohibit Indian gambling if it is a type of gambling that the state allows for non-Indians. States' rights to control Indian gambling are sharply limited under federal law.

The states have no role in regulating bingo and other class II games. If a state allows a class II game to be played on non-Indian lands, tribes have a right to conduct that game under a federally approved tribal ordinance. Unbanked card games played under a tribal ordinance have to abide by state laws on hours of play and wagering limits.

If a state allows blackjack, slot machines, and other class III games for non-Indians, it cannot refuse to negotiate a compact for those games with an Indian tribe that requests it. Under the federal law, a state's refusal to negotiate gives the tribe the right to go to federal court to seek a court order requiring further negotiations. If further negotiations still fail to result in a compact, each side must submit a proposal to a court-appointed mediator who selects the proposal that is the more consistent with the federal law. A state that objects to the mediator's decision may appeal to the Secretary of the Interior. At that point, the secretary prescribes the compact, taking into consideration the mediator's decision, state law, and federal law.

***States negotiate compacts with tribes***

Minnesota has negotiated 22 tribal-state compacts with 11 Indian tribes, resulting in the establishment of 18 casinos in the state. The class III games permitted under these compacts are blackjack and video games of chance.

The compacts provide for inspection and approval of machines by the state Department of Public Safety, licensing of casino employees, standards for employees (no prior felony convictions, etc.), machine payout percentages, and regulation of the play of blackjack. In addition, if off-track betting on horse racing is ever permitted in Minnesota (the law authorizing it was declared unconstitutional by the state supreme court), there could be one Indian off-track betting establishment for each non-Indian establishment in the state.

Both types of compacts (video games and blackjack) provide that they remain in effect until the two parties renegotiate them. Either party can request a renegotiation at any time.

***States can't tax Indian gambling to raise general revenue***

IGRA specifically prohibits states from imposing taxes or fees on Indian gambling, except for fees that the tribe agrees to. These fees are intended to compensate the state for its costs in performing inspections and other regulation under the tribal-state compact. In other words, states cannot raise general revenue by taxing Indian gambling.

Some states, notably Connecticut, have negotiated agreements with Indian tribes under which the tribe voluntarily pays the state a percentage of gambling revenue in exchange for state agreement to maintain tribal monopoly over certain types of gambling.

**For more information:** Contact legislative analyst Patrick McCormack at 651-296-5048. Also see the House Research publication *Indians, Indian Tribes, and State Government*, January 2007.

Janelle Taylor September 2008

# Dedicated Funding for Natural Resources, Arts, and Cultural Purposes
## A Proposed Constitutional Amendment

A proposed constitutional amendment to raise the sales tax rate 3/8 of 1 percent and dedicate the revenue for natural resources and the arts will be on the ballot at the November 2008 general election. Voters will decide whether or not to ratify the amendment.

***The Amendment***

The 2008 Legislature proposed a constitutional amendment that would raise the state's sales tax rate by 3/8 of 1 percent and dedicate the revenue for natural resources and the arts (Laws 2008, ch. 151). The question to be presented to the voters in the November 2008 general election is:

> "Shall the Minnesota Constitution be amended to dedicate funding to protect our drinking water sources; to protect, enhance, and restore our wetlands, prairies, forests, and fish, game, and wildlife habitat; to preserve our arts and cultural heritage; to support our parks and trails; and to protect, enhance, and restore our lakes, rivers, streams, and groundwater by increasing the sales and use tax rate beginning July 1, 2009, by three-eighths of one percent on taxable sales until the year 2034?"

***Allocation of Funds***

If passed the amendment would raise approximately $274 million dollars in fiscal year 2011. (Fiscal year 2011 amounts are used because that is the first full year of receipts from the dedication.) The amendment specifies how the money shall be allocated among four funds and states that the funds must supplement traditional sources of funding and not substitute traditional funding sources. Below is a description of the four funds and how they are to be used.

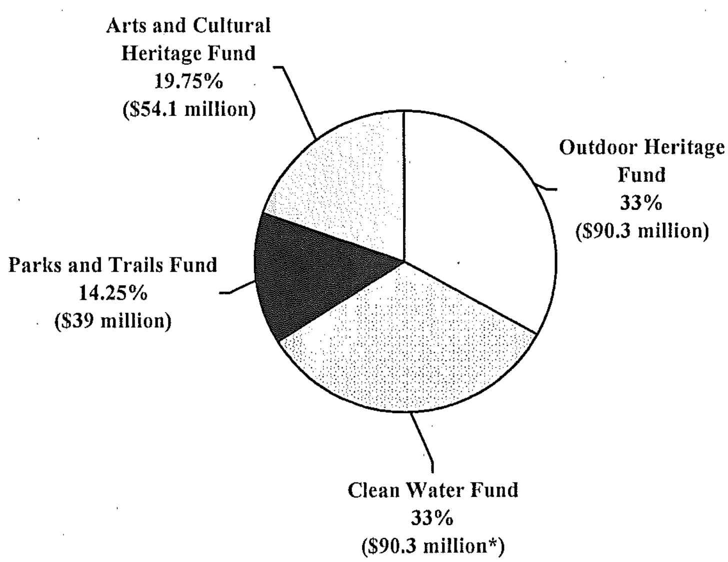
- **Outdoor Heritage Fund.** This fund would receive 33 percent of the revenues, which must be used to "restore, protect, and enhance wetlands, prairies, forests, and habitat for fish, game, and wildlife." If the amendment passes, a council made up of four legislators and eight appointed citizens called the "Lessard Outdoor Heritage Council" would be established with the responsibility of providing annual recommendations to the legislature on how the funds should be used. (The legislation establishing the council was passed separately as part of the omnibus game and fish bill (Laws 2008, ch. 368, art. 2, §§ 1 and 14).) Four of the citizens would be appointed by the governor, two would be appointed by the speaker of the House, and two would be appointed by a subcommittee of the Senate.
- **Clean Water Fund.** This fund would also receive 33 percent of the revenues, which must be used to "protect, enhance, and restore water

quality in lakes, rivers, and streams and to protect groundwater from degradation." An account within the fund would also be established (the sustainable drinking water account) that would receive at least 5 percent of the clean water fund. This account would only be used to protect drinking water sources.

- **Parks and Trails Fund.** This fund would receive 14.25 percent of the revenues, which must be used to support parks and trails that are of "regional or statewide significance."

- **Arts and Cultural Heritage Fund.** This fund would receive 19.75 percent of the revenues, which must be used for "arts, arts education, and arts access and to preserve Minnesota's history and cultural heritage."

**Allocation of Proposed Annual Dedicated Sales Tax Revenue (FY 2011 Revenue Estimate)**




*Of the $90.3 million, at least 5 percent ($4.5 million) would go to the Sustainable Drinking Water Fund.
Source: Department of Finance, February 2008 forecast.

**For more information:** Contact legislative analyst Janelle Taylor at janelle.taylor@house.mn. Also see the House Research publication *A Chronology of Recent Legislation to Dedicate Funding for Natural Resources Purposes*, January 2007.

Patrick McCormack Updated: September 2008

# Texas Hold'em

Texas hold'em is an increasingly popular form of poker in which each player is dealt two cards and there are five common cards. In 2005, the legislature enacted a law authorizing Texas hold'em tournaments that are conducted according to certain requirements.

***Does Minnesota prohibit all forms of betting?***

Minnesota law generally prohibits betting and the operation of any location where betting is permitted or promoted. A "bet" occurs when parties agree that one party will give another party money, property, or some other benefit in the event of an outcome that is dependent upon chance, even if the outcome is also dependent upon an element of skill.

Over time, Minnesota has established a number of statutory exceptions to the general prohibition of betting. For example, Minnesota law authorizes the operation of a state lottery, bets on horse races at licensed racetracks, and private social bets that are not part of or incidental to organized, commercialized, or systematic gambling. Minnesota also allows gambling on some social skill games (e.g., cribbage, bridge, gin) and social dice games (e.g., "shake-a-day," "3-2-1," "who buys"), provided that they meet certain conditions.

***When are card tournaments legal?***

Minnesota permits gambling in certain card tournaments, as long as the tournaments do not provide any direct financial benefit to the promoter or organizer and the value of all prizes awarded in a tournament does not exceed $200.

Until June 2005, only ten card games were permitted under these circumstances: cribbage, skat, sheephead, bridge, euchre, pinochle, gin, 500, smear, and whist. However, as of June 4, 2005, Texas hold'em tournaments and contests are also permitted, subject to the restrictions described below. Gambling in tournaments consisting of any other social skill game are illegal in Minnesota.

***When are Texas hold'em tournaments legal?***

Texas hold'em tournaments are subject to the same restrictions as other social skill game tournaments in Minnesota. However, there are additional requirements for Texas hold'em tournaments that do not apply to other social skill game tournaments.

***Can players be charged to participate in a Texas hold'em tournament?***

Players in Texas hold'em tournaments cannot be charged *any* fee or be required to give *any* consideration (something of value) as a condition of participation. In other words, players must be able to participate in a Texas hold'em tournament for free.

| | |
|---|---|
| ***Can prizes be awarded in a Texas hold'em tournament?*** | Prizes can be awarded in Texas hold'em tournaments. However, as is the case with tournaments involving other social skill games, the value of all prizes awarded in a single tournament cannot exceed $200. With respect to Texas hold'em, the law further specifies that the value of all prizes awarded to *an individual winner* of a tournament at a single location may not exceed $200 per day. |
| ***Is there an age requirement to play Texas hold'em?*** | To participate in a Texas hold'em tournament or contest, a player must be at least 18 years old. |
| ***Can players with disabilities participate in Texas hold'em tournaments?*** | Minnesota law requires the organizer or promoter of any Texas hold'em tournament to ensure that reasonable accommodations are made for players with disabilities. In addition to making other accommodations to tournament tables and cards, a tournament organizer or promoter has to make sure that Braille cards are available for blind players and that the cards visible to the entire table are announced. |
| ***Who regulates Texas hold'em tournaments?*** | The Alcohol and Gambling Enforcement Division (AGED), Department of Public Safety, in conjunction with local law enforcement authorities, has jurisdiction over Texas hold'em tournaments and other social skill game tournaments. The Gambling Control Board has no jurisdiction over these tournaments. It is appropriate to contact a local county attorney with questions about the conduct of Texas hold'em tournaments. |

**For more information:** Contact legislative analyst Patrick McCormack by e-mail at patrick.mccormack@house.mn.

HOUSE RESEARCH | Short Subjects

Karen Baker and Deborah Dyson

Updated: October 2008

# Special Assessments: An Overview

***What are special assessments?***

Special assessments are one of the ways a local government may collect money to pay for local improvements. A special assessment is a charge imposed on real property to help pay for a local improvement that benefits the property. The Minnesota Constitution gives the legislature the authority to allow local governments to use special assessments. This authority is mainly in Minnesota Statutes, chapter 429.

***What can special assessments be used for?***

Different types of local governments can use special assessments to pay for different types of local improvements. Cities, towns, urban towns, and counties can all use special assessments for the purposes listed in chapter 429. The statute doesn't apply to home rule charter cities if their charters establish other procedures. Chapter 429 lists improvements that local governments can pay for with special assessments. Some examples include streets and roads, storm sewers, street lights, parks, nuisance abatement, district heating systems, and flood control works. For a comprehensive list, see Minnesota Statutes, section 429.021, subdivision 1.

***How is the amount of a special assessment determined?***

The special assessment cannot exceed the amount by which the property benefits from the improvement. The amount a property benefits from an improvement, called the "special benefit," is measured by the increase in the market value of the land due to the improvement. The assessment must be uniformly applied to the same class of property. A local improvement may benefit properties that are not abutting the improvement, and those properties may also be assessed.

***How are special assessments imposed?***

Local governments generally follow a set of procedures outlined in chapter 429 to impose special assessments. The procedures may vary depending on the purpose for the special assessment. The process can be divided into roughly three phases: (1) initiation and preliminary assessment, (2) detailed analysis, and (3) approval of final assessment roll, certification, and collection.

During the initiation and preliminary assessment, a local government initiates the proceeding, prepares a report on the necessity, cost-effectiveness, and feasibility of the proposed improvement, gives notice of public hearing, conducts a public hearing, and adopts a resolution ordering the improvement.

In the detailed analysis phase, the local government solicits bids, prepares a proposed assessment roll, gives notice of a public hearing, notifies affected properties of the proposed assessment, and conducts a public hearing. A property owner must file a written objection to a proposed assessment in order to preserve the right to appeal to the district court.

In the final phase, the local government approves and certifies the assessment roll, issues debt to finance the improvement, collects the assessment, and awards a contract for work on the improvement. A property owner has 30 days to appeal the assessment to district court. In order to issue local improvement bonds without an election, at least 20 percent of the project cost must be paid with special assessments.

***Can special assessments be deferred or delayed?***

Special assessments can be deferred for senior citizens, people who are disabled, and active members of the National Guard and military reserve ("hardship deferral"); for property that is enrolled in the Minnesota Agricultural Property Tax Program (Green Acres); and for unimproved land. In some cases, collection of assessments for street or road improvement made outside municipal boundaries may be delayed until the area is annexed.

***How are special assessments different from property taxes?***

Special assessments are a form of taxation and may be paid using the same mechanism and at the same time as property taxes. However, special assessments and property taxes differ on the following:

- The basis for determining the amount charged (market value vs. benefit)
- What real property is subject to charge (taxable property vs. all real property, including tax-exempt property)
- That personal property is not subject to special assessments (but may be subject to property tax)
- Whether there are any statutory limits (debt limits do not apply to local improvement bonds; property tax levy limits do not apply to special assessments)
- Deductibility for income tax purposes (special assessments are generally not deductible for federal or state taxes)

***Who imposes most special assessments and what are the trends?***

In 2006, 71 percent of all special assessments were imposed by cities. City use of special assessments decreased from 1980 to 2006, both as a percentage of total revenue, from 13.5 percent to 6.3 percent, and as a percentage of total property tax levy, from 20.5 percent to 10.9 percent.

***Can services and unpaid charges be collected as if they are special assessments?***

Cities and urban towns may impose by ordinance charges to pay for certain services that often are paid for with general revenues (e.g., property taxes). In addition, they may adopt an ordinance to collect unpaid charges imposed on an individual property using the special assessment collection process. Minnesota Statutes, section 429.101, lists the services that can be paid for as if they are special assessments.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959 or Deborah Dyson at 651-296-8291. Also see the House Research publication *Special Assessments*, September 2008.

HOUSE RESEARCH | Short Subjects

Lynn Aves

Updated: October 2008

# Human Services Programs: The Relationship Between Federal, State, and Local Governments

Minnesota has a system of human services programs that provides health care, economic assistance, and social services to eligible families. In general, the state's human services programs are state-administered and county-run. This means that county human services agencies process applications, determine the eligibility of applicants, and perform other administrative duties, under the supervision of the Minnesota Department of Human Services (DHS). DHS also is responsible for sending out cash assistance payments to program enrollees and for reimbursing health care providers and managed care plans for services provided to program enrollees. In the case of programs established in federal law, DHS is also responsible for overall state compliance with applicable federal requirements.

This publication provides a brief discussion of the role of federal, state, and local governments in the administration of the state's human services programs.

***What is the federal government's role in the state's human services programs?***

Congress enacts laws that set broad standards and requirements for certain human services programs. For example, federal law requires the Medical Assistance (MA) program (Minnesota's version of the federal-state Medicaid program) to cover certain population groups and certain health care services.

The federal government also appropriates money to the state for the administration of certain human services programs. In order to qualify for federal funding, Congress often requires the state to enact various kinds of legislation. For example, the federal government contributes approximately 75 percent of the state's total child support enforcement funding. To qualify for this federal funding, the legislature has enacted certain requirements relating to child support enforcement. Typically, these federal requirements are quite general in nature, leaving the details up to the legislature.

***What is state government's role in administering human services programs?***

The state legislature sets human services policy in Minnesota. In many cases, state policy is greatly influenced by the federal law requirements that are prerequisites to receiving federal funding. Although state law must include certain federal requirements, the state legislature may enact provisions that go beyond the minimum federal requirements. For example, the MA program covers population groups and health care services that federal Medicaid law designates as optional for states, rather than required.

DHS is the primary executive branch agency responsible for overseeing the state's human services programs. DHS supervises human services program administration, promulgates rules, and develops program manuals and bulletins governing the administration of the programs. DHS also provides training and technical support to counties and maintains centralized computer systems relating to the programs.

***What is the local government's role in administering human services programs?***

Counties do much of the hands-on work in administering the state's human services programs. For example, county staff accept applications and determine eligibility for a wide range of income assistance and health care programs. County staff also negotiate payment rates for certain residential facilities and health care providers, subject to state maximums. County staff also work with parents to help establish and enforce child support obligations.

For certain human services programs, counties also contribute to program funding through local property tax revenue. For example, counties provide approximately 14 percent of the state's total child support enforcement funding.

Matt Burress

Updated: October 2008

# Minnesota Highway Funding Sources

***Funding framework***

The Minnesota Constitution provides the main framework for highway funding, establishing three highway user taxes and dedicating the revenue to transportation purposes. Minn. Const. art. XIV. State statutes further specify allocation formulas and various requirements. Other funding sources include federal aid, penalties and fines, and inter-governmental contracts, all which mainly fund the trunk highway system.

***Motor fuels tax***

The motor fuels tax is imposed at a per-gallon rate and collected from petroleum distributors. The tax rate depends on how the fuel is classified under state law. The rate for regular gasoline is the same for diesel and certain gasoline blends. Minn. Stat. § 296A.07, subd. 3. The tax rate for other fuel types such as E85 and special fuels (like compressed natural gas) is proportional to the rate of the tax on gasoline, based on the energy content of that fuel.

The tax applies only to motor fuel used on highways. The amount paid on fuel used in nonhighway commercial operations, principally farming, is refunded. A portion of motor fuel tax revenue is attributed to nonhighway recreational use, such as in motorboats, snowmobiles, and ATVs. That revenue goes into dedicated Department of Natural Resources funds for those respective activities. Minn. Stat. § 296A.18.

**Gasoline Tax Phase-In**

| Period | Rate (cents) |
|---|---|
| FY 2008-09 | |
| Thru 3/31/08 | 20.0 |
| 4/1/08 – 7/31/08 | 22.0 |
| 8/1/08 – 9/30/08 | 22.5 |
| 10/1/08 – 6/30/09 | 25.5 |
| FY 2010 | 27.1 |
| FY 2011 | 27.5 |
| FY 2012 | 28.0 |
| FY 2013 & After | 28.5 |

Legislation enacted in 2008 will phase in an 8.5-cent tax increase, so that starting in fiscal year 2013, the rate for gas and diesel fuel will be 28.5 cents per gallon. This includes both a 5-cent tax rate increase and a 3.5-cent debt service surcharge designed to cover trunk highway bonds also authorized in the act. Laws 2008, ch. 152, art. 2, § 1, and art. 3, §§ 3–6.

***Motor vehicle registration tax***

The state imposes a registration tax (also known as tab fees) on motor vehicles domiciled in Minnesota. The annual tax applies to passenger vehicles as well as trucks and other vehicles that use the state's highways. A major exception is vehicles owned by government agencies (including school buses).

For passenger vehicles, the rate depends on a combination of the vehicle's original value and its age. Vehicles are taxed at $10 plus 1.25 percent of the base value multiplied by a depreciation factor. Minn. Stat. § 168.013, subd. 1a. The base value is the manufacturer's base price (without options) for a particular make and model when the vehicle was new. The depreciation factor is a yearly reduction in base value following a statutory schedule. The depreciation equals 100 percent of the base value in the vehicle's first year of life and 90 percent in its second year. It drops by 10 percent a year until its eleventh year (when the rate changes from a percentage to a flat $25 amount). Legislation in 2008 modified the schedule for depreciating the base value and eliminated caps on the amount of tax owed. Laws 2008, ch. 152, art. 3, § 1.

Trucks are taxed on the basis of weight and age. The tax on trucks and truck-tractors ranges from a minimum of $120 to $1,760 for a power unit hauling up to 81,000 pounds, with a 25-percent reduction after eight years of life. Minn. Stat. § 168.013, subd. 1e. Farm trucks pay a reduced weight-based tax. Buses pay a tax ranging from $125 to $550 depending on weight, with depreciation beginning in the third year of life. Motorcycles pay a flat tax of $10 annually.

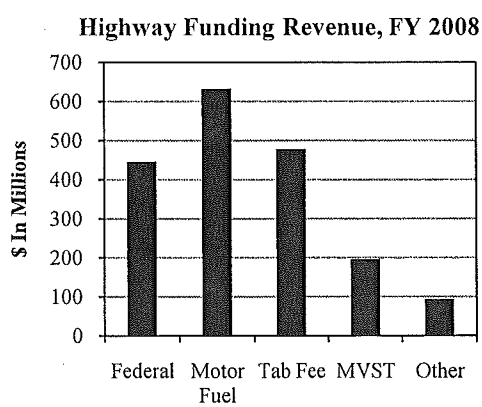
***Motor vehicle sales tax***

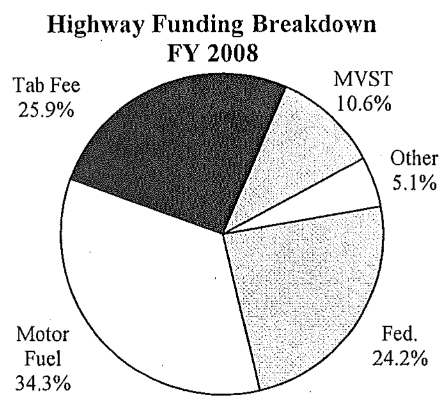
The motor vehicle sales tax, or MVST, is a 6.5-percent tax applied to the sale of new and used motor vehicles. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax and is based on the purchase price of the motor vehicle. Some older autos as well as collector's vehicles have a flat tax instead. MVST is collected by auto dealers or when the vehicle is registered.

Historically, MVST revenue has gone to both transportation and the general fund. Voters in 2006 approved a constitutional amendment that gradually dedicates all MVST revenue to transportation purposes. The amendment specifies that 63.75 percent must be dedicated to transportation in fiscal year 2008, growing by 10 percent per year until reaching 100 percent in fiscal year 2012. It also requires that "no more than 60 percent" of the revenue go to highways and "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13.

Legislation in 2007 established an MVST phase-in schedule that specifies the actual division between highways and transit. Minn. Stat. § 297B.09. In fiscal year 2012, after the phase-in, the revenues will be distributed 60 percent to highways and 40 percent to transit, with the transit portion divided into 36 percent for the metropolitan area and 4 percent for greater Minnesota.

***Highway funding revenue***




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 Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

Karen Baker & Deborah Dyson October 2008

# Subordinate Service Districts

Beginning in 1969, a few metropolitan area counties were authorized to establish "subordinate service districts" by special law. Since 1982, counties, other than the seven metropolitan counties and St. Louis County, have been able to establish subordinate service districts under general law (Minn. Stat. ch. 375B). Towns were authorized to establish subordinate service districts in 1989 (Minn. Stat. ch 365A). Subordinate service districts are very similar to city special service districts.

***What is a subordinate service district?***

A subordinate service district is a geographic area within a county or town, smaller than the entire county or town, in which the county or town provides services at a higher level than are provided generally throughout the jurisdiction or provides services that are not provided at all in the jurisdiction. A county subordinate service district (but not a town's) must be a compact, contiguous area.

***What services can be provided in a subordinate service district?***

Any service that the county or the town is otherwise authorized by law to provide may be provided in a district. Op. Atty Gen. 125a (March 26, 1984). County and town subordinate service districts cannot overlap to provide the same service. Minn. Stat. § 365A.10. Anecdotally, the law has been used to pave a portion of town road, provide community sewage treatment systems (CSTS) in new developments and near lakes, and provide ambulance services. There is no comprehensive information on the number, location, purpose, or financing of subordinate service districts; counties and towns do not report on them to any state agency.

***How are the services paid for?***

The services are paid for by revenues from within the district. For both counties and towns, a service may be paid for through a property tax or service charge, or a combination of the two, against the users of the service. Counties and towns may issue general obligation bonds without an election for capital projects in subordinate service districts, payable primarily from the taxes or charges from the district but also ultimately backed by the general taxing power of the county or town. The taxes or fees supporting the bonds must continue to be imposed until the bonds are repaid, even if the district is dissolved. Minn. Stat. §§ 375B.09; 365A.08; 365A.095.

***How is it different from other ways of paying for the improvements or services?***

If the county or town used general property tax levy revenues, the entire jurisdiction would pay for the improvement or service. A subordinate service district requires those benefitting from or using the improvements or services to pay for them. Assuming the county or town had authority to use special assessments for the particular purpose, special assessments typically are not for ongoing costs, and the amount charged must be substantially equal to the property's market value increase due to the improvement. In contrast, a subordinate service district can be used to pay for ongoing costs and does not require the charges to match the benefit.

***How is a subordinate service district formed?***

**By board resolution.** A county board may establish a district by resolution after a public hearing. The resolution must specify the service or services to be provided within the subordinate service district and the territorial boundaries of the district. Minn. Stat. § 375B.04.

**By petition.** In a county and in a town, a subordinate service district may be established by petition. In a county, the petition submitted to the county board must be signed by at least 10 percent of *voters* within the area proposed for the subordinate service district. In a town, it must be signed by at least 50 percent of the *property owners* in the area to be served. In both cases, the petition must describe the proposed district boundaries and services. Within 30 days, the county or town board must hold a public hearing and then approve, approve with modifications, or disapprove the request.

Whether created by board resolution or petition, creation of a subordinate service district is subject to reverse referendum. If 5 percent of voters in the district (for counties) or 25 percent of property owners in the district (for towns) petition for a referendum, a special election must be held. When this occurs, the district is not established unless approved by a majority of those voting on the question. Minn. Stat. §§ 365A.06; 375B.05.

***Can a district be enlarged?***

A county subordinate service district may be enlarged in the same manner for establishing a new district. Minn. Stat. § 375B.08. The statute specifies who can vote.

***How is a district discontinued?***

Both county and town subordinate service districts may be discontinued if a petition requesting it is approved. For counties, the petition must be signed by at least 10 percent of the voters in the area. Counties are not required to hold public hearings. A county board also may initiate discontinuing a district by adopting a resolution after publishing notice for between three and six months before the resolution is adopted. In a county, whether initiated by petition or board resolution, the county must hold a special election within the boundaries of the district not less than 30 nor more than 90 days after the resolution or receipt of the petition. The district is discontinued if a majority of those voting on the question favor discontinuance. For towns, the petition must be signed by at least 75 percent of the property owners in the area. Town boards must hold a public hearing before deciding whether to discontinue a subordinate service district, but no election is held. Minn. Stat. §§ 365A.095; 375B.10; 375B.11.

If revenues remain after a town subordinate service district is discontinued and all outstanding obligations have been paid, the town board may deposit the surplus revenues in the town general fund or refund them to the owners of property charged during the last year a tax or fee was imposed in the district. Minn. Stat. § 365A.095. The county subordinate service district law does not address this situation.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959 or Deborah Dyson at 651-296-8291. Also see the House Research publication *City Special Service Districts*, September 2005.

# HOUSE RESEARCH | Short Subjects

Joel Michael and Nina Manzi

Updated: October 2008

## Revenue Recapture Program

*Revenue recapture allows the 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:

- 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 $10,670 and $20,170 in 2007, depending upon family size) to repay Medical Assistance cannot be recaptured. Debts barred by the statute of limitations also cannot be recaptured.

Amounts available to offset qualifying debts are applied first to unpaid taxes, interest, and penalties before revenue recapture takes effect.

*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

*The claimant 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:

- Child support obligations
- Restitution obligations
- Claims submitted for a hospital or ambulance service
- Other debts based on the order in which DOR received the claims

DOR accounts receivable (e.g., unpaid taxes, interest, and penalties) are offset before claims under revenue recapture.

*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 $68 million was recaptured in 2007*

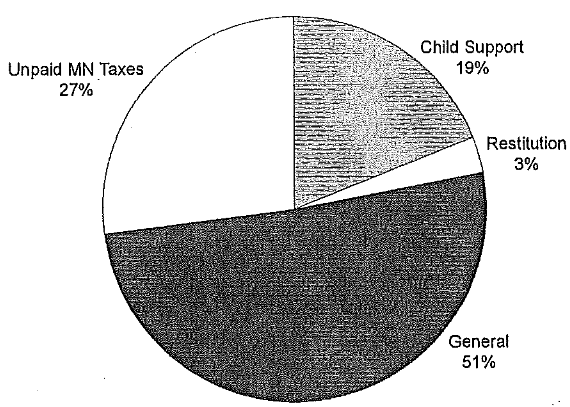
The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2003 to 2007.

The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2003 to 2007 by the four major types of debts for which the law sets priorities.

**Revenue Recapture Amounts CY2003-2007**

| | Number of Offsets | Amount of Recapture |
|---|---|---|
| **2003** | 184,641 | $51,206,131 |
| **2004** | 204,077 | $54,804,757 |
| **2005** | 210,655 | $59,247,902 |
| **2006** | 179,754 | $59,945,770 |
| **2007** | 211,636 | $68,275,418 |

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




**For more information:** See www.taxes.state.mn.us/collection/rr_index.shtml for more information for claimant agencies.

Mark Shepard & Patrick McCormack Updated: October 2008

# Special Sessions of the Minnesota Legislature

***The governor may call the legislature into special session on extraordinary occasions***

Besides requiring the legislature to meet in *regular* session during a part of each biennium (two-year period), the Minnesota Constitution permits the legislature to meet in *special* session "on extraordinary occasions."

Some state legislatures are allowed to call themselves into special session. The Minnesota Constitution does not permit this: only the governor can call the legislature into special session. (Statutory law purports to allow the legislature to call itself into special session, under certain circumstances, when the state is under attack by enemies of the United States.)

Statutory law directs the governor to call a special session by means of a proclamation, to notify all legislators of the time of the meeting, and to inform the legislature of the purpose of the session. The governor's proclamation is filed with the secretary of state and is printed in the journal of each house and in the *Laws of Minnesota* (a compilation of legislative actions published each year).

***Special sessions permit legislative action at any time of the year***

Special sessions permit legislative action, if necessary, at times when the legislature is not meeting, or allowed by the constitution to meet, in regular session (generally, the summer and autumn months). Typically governors call special sessions for two reasons:

- The legislature has not completed work on vital legislation during the time allowed for the regular session
- Changed circumstances require urgent legislative action after the regular session ends

It is possible for a special session to run concurrently with a regular session—either because a special session continues after the start of a regular session, or because the governor chooses to call a special session during a regular session. This overlapping of special and regular sessions has occurred only once, in 1981.

***Special sessions have become more frequent in recent decades***

Special sessions once were rare but have become more frequent. According to information complied by the Legislative Reference Library, governors called three special sessions during the first half century of statehood (1857-1906), ten in the succeeding half century (1907-1956), and 31 in the nearly 50 years since 1957. As many as six special sessions have been called during a single legislative biennium (in 1981-82).

***Each special session is discrete***

Each special session is a separate, free-standing meeting of the legislature, independent of the regular legislative session and any other special session. All legislation to be considered must be introduced as new bills. The legislature may not act on bills from the regular session or another special session.

***The legislature determines the length and scope of a special session***

Legislators decide what issues and legislation to consider in a special session and how long to meet. Governors initiate special sessions but have no authority to limit their scope or duration. Nor does the constitution regulate the length of special sessions, as it does regular sessions. Once they are called into a special session, legislators could decide to take up a large agenda and meet for a lengthy period—even, in theory, until legislative terms of office end and a new legislature convenes in regular session, in January of the next odd-numbered year.

***Most special sessions are quite concentrated and short***

Despite the legislature's unbridled authority to determine the scope and length of special sessions, long rambling ones are rare. The length of most is best measured in hours or days. Seldom does one extend beyond a single week. The longest in history—by far—occurred in 1971, when a special session convened in late May and did not adjourn finally until the end of October.

Two common practices contribute to the brevity of most special sessions.

**First, the governor and legislative leaders seek agreement on the business of the session before the governor calls it.** Some agreement on the general scope of the session usually is possible. This is announced publicly before the session and reflected in a general way in the language of the governor's proclamation. A typical proclamation these days recites the need for essential laws in specified subjects and calls for the prompt conclusion of legislative business, with a limited agenda and as much prior agreement as possible. Besides seeking agreement on the general scope of the session, the leaders also may attempt to reach more detailed agreements about the content of legislation.

**Second, the legislature usually uses expedited procedures to pass legislation.** During special sessions, the House and the Senate often pass bills shortly after they are introduced. This is accomplished by declaring an "urgency" and suspending both the constitutional requirement that each bill be considered on three different days in each house and the requirement of legislative rules that each bill be referred to a committee when it is introduced. The two-thirds vote required in each house to expedite passage in this way usually is forthcoming, because legislators generally wish to curb the length of the session.

**For more information:** Contact Mark Shepard at 651-296-5051 or Patrick McCormack at 651-296-5048. Also see the House Research publication *Regular Sessions of the Minnesota Legislature*, October 2008.

Mark Shepard

Updated: October 2008

# State Agency Head Salaries

*Salaries for executive agency heads are proposed by the appointing authority and approved by the legislature*

The executive appointing authority proposes salaries for agency heads, within maximums established in law. Minn. Stat. § 15A.0815. The governor is the appointing authority for most agency heads. Some agency heads are appointed by other boards (e.g., public pension boards).

The maximum salary for most agency heads is 95 percent of the governor's salary. For several agency heads, the maximum is 85 percent of the governor's salary. Minn. Stat. § 15A.0815, subds. 2 and 3. The governor's salary is $120,303 (95 percent of this amount is $114,288; 85 percent is $102,258).

Salaries recommended by the appointing authority must be approved by the legislature. During the interim between legislative sessions, the Legislative Coordinating Commission (LCC) may give interim approval to salary increase proposals. The LCC has appointed a Subcommittee on Employee Relations (SER) to perform these and other duties. Salary proposals from the governor submitted to SER during the interim are approved if the group does not modify or reject them within 30 days. Salary proposals submitted by other appointing authorities during the interim take effect only if approved by SER. Salaries implemented during the interim by SER must be approved by the next legislature or they revert to the prior level. Salary proposals sent to the legislature during a legislative session must be approved by the full legislature before taking effect. Minn. Stat. §§ 3.855 and 15A.0815, subd. 5.

There is a different method for setting the salaries of the director of the lottery and the executive director of the State Board of Investment. The lottery director salary is set in statute at 95 percent of the governor's salary ($114,288). Minn. Stat. § 349A.02, subd. 1. The salary for the executive director of the State Board of Investment ($245,000) is set by the board, under a compensation plan approved by the SER and the full legislature. Minn. Stat. §§ 11A.04, cl. 14, and 43A.18, subd. 3b.

*Agency head salaries*

The following table lists the salaries for agency heads appointed by boards, cabinet agency heads, and noncabinet agency heads.

| Agency Heads Appointed by Boards | Salaries |
|---|---|
| Minnesota State Retirement System | $114,288 |
| Public Employees Retirement Association | 114,288 |
| Teachers Retirement Association | 114,288 |

| Cabinet Agencies | Salaries |
|---|---|
| Administration | $108,393 |
| Agriculture | 108,393 |
| Commerce | 108,393 |
| Corrections | 108,393 |
| Education | 108,393 |
| Employment and Economic Development | 108,393 |
| Finance | 108,393 |
| Health | 108,393 |
| Office of Higher Education | 108,393 |
| Housing Finance Agency | 108,393 |
| Human Rights | 108,393 |
| Human Services | 108,393 |
| Iron Range Resources and Rehabilitation | 95,641 |
| Labor and Industry | 108,393 |
| Mediation Services | 95,641 |
| Metropolitan Council, Chair | 58,489 |
| Natural Resources | 108,393 |
| Pollution Control Agency | 108,393 |
| Public Safety | 108,393 |
| Revenue | 108,393 |
| Transportation | 108,393 |
| Veterans Affairs | 108,393 |
| **Noncabinet Agencies** | |
| Gambling Control Board | $90,200 |
| Metropolitan Airports Commission, Chair | 20,833 |
| Ombudsman for Mental Health and Retardation | 88,455 |
| Pari-mutuel Racing | 88,455 |
| Public Utilities Commission | 88,455 |

Salaries for most agency heads were last increased in 2000.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051.

HOUSE RESEARCH | Short Subjects

Mark Shepard & Patrick McCormack Updated: October 2008

# Regular Sessions of the Minnesota Legislature

***The legislature is required to meet regularly***

The Minnesota Constitution requires the legislature to meet each biennium, during the two-year term of office of members of the House of Representatives. The constitution leaves the timing of these "regular" legislative sessions to be prescribed by law. The law says that regular sessions are to begin just after newly elected legislators commence their term of office on the first Monday in January of the odd-numbered year.

***Each regular session is conducted by a distinct legislature***

The convening of each new regular session marks the end of one legislature and the beginning of another, because all representatives, and sometimes all senators, are starting a new term of office. Sessions, and legislatures, are numbered in sequence. The first regular session and the first state legislature convened in December 1857. The regular session beginning in January 2009 is the 86th regular session, and the legislature that meets then is the 86th Legislature.

***The constitution allows only one regular session in a biennium***

Once convened in regular session, the houses of the legislature continue the session simply by adjourning from one day to another. The regular session ends when the houses adjourn *sine die* (without setting a date for reconvening). After a legislature adjourns *sine die*, it may not meet again in regular session that biennium. The legislature continues to exist and may be called into a "special session" by the governor, but the regular session for that biennium is finished.

***The constitution regulates the length of the regular session***

Three provisions of the constitution regulate the length of the regular session.

**The session is limited to 120 legislative days**, as that term is defined by law. The law defines a legislative day as a day on which either house is called to order—that is, meets in a "floor session" in its chamber in the Capitol. Legislative committees may meet without consuming a legislative day, as long as neither house meets on the floor that day.

**The legislature normally must use at least two legislative days each week.** The constitution does not allow either house to adjourn for more than three calendar days (excepting Sunday) without the consent of the other house. Although the two houses could agree to frequent long adjournments, in practice they do not. Both routinely comply with the constitutional requirement by scheduling a minimum of two floor sessions each week, even when there is little floor business to conduct.

**The legislature may not meet in regular session after a specified day in May.** The constitution forbids the legislature to meet in regular session after the first Monday following the third Saturday in May in any year. This provision confines regular sessions to the first five months of any year.

*Apart from these requirements, each legislature may schedule its regular session as it pleases*

These constitutional and statutory regulations establish what is called a "flexible biennial session." The session is flexible because each legislature may schedule its regular session meetings as it pleases, as long as it does not exceed 120 legislative days or meet outside of the January-to-May period. The session is biennial because each legislature is allowed, though not required, to meet in both years of the biennium: when it closes the regular session in the first year, the legislature can choose to adjourn either *sine die* or to a date it specifies in the following year.

Every legislature since 1973, when these regulations took effect, has the chosen to spread its regular session over both years. The result is this typical configuration:

- *First year:* The session begins on the prescribed day, early in January of the odd-numbered year. The session continues for nearly five months, until the constitutional deadline in May, when both houses adjourn until a date they specify in the following (even-numbered) year.
- *Second year:* On the specified date in the following year usually sometime in January or February, the two houses reconvene to continue the regular session. The session in the second year typically lasts three or four months when both houses bring the regular session to an end by adjourning *sine die*.

*Historically, the legislature met annually at first, then in alternate years, and now in flexible biennial sessions*

**1857-1878: Annual sessions.** The 1857 state constitution limited neither the frequency nor the duration of legislative sessions. The first legislatures met annually in sessions lasting as long as four or five months. An 1860 constitutional amendment limited each annual session to 60 days. Accordingly, in 1861 the legislature began meeting each year for 60 calendar days, from early January to early March.

**1879-1972: Alternate-year sessions.** An 1877 constitutional amendment retained the 60-day limit but directed the legislature to "meet biennially." So beginning in 1879, and for nearly 100 years thereafter, the legislature met only in odd-numbered years. An 1888 constitutional amendment changed the 60-day limit to 90 "legislative days"—which was understood to mean that Sundays and legal holidays could be disregarded in reckoning the 90-day span of the session. A 1962 constitutional amendment raised the limit of legislative days from 90 to 120 and replaced the constitutional direction to "meet biennially" with a more explicit direction confining regular session to "each odd-numbered year."

**1973-present: Flexible biennial sessions.** The flexible session amendment to the constitution, adopted in 1972, removed the provision confining regular sessions to odd-numbered years, added the May adjournment deadline, and directed that "legislative day" be defined by law. A 1973 law defined legislative day as a day when either house convenes in a floor session. Since then, the legislature has met in a single regular session spread over both years of each biennium.

**For more information:** Contact Mark Shepard at 651-296-5051 or Patrick McCormack at 651-296-5048. Also see the House Research publication *Special Sessions of the Minnesota Legislature*, October 2008.

Joel Michael

Updated: October 2008

# 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 2008 weights sales at 81 percent, property at 9.5 percent, and payroll at 9.5 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:

$$MN\ percent = \left(0.81 * \frac{MnSales}{TotalSales}\right) + \left(0.095 * \frac{Mn\text{Property}}{\text{TotalProperty}}\right) + \left(0.095 * \frac{MnPayroll}{TotalPayroll}\right)$$

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,* June 2008, and *Corporate Franchise Taxation*, October 2008.

**Deborah A. Dyson**



**Revised: October 2008**


# "60-Day Rule"
# Deadline for Certain Agency Actions

***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."

***Who does it apply to?***

The law applies to the following, all defined as "agencies":

- 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
- 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."

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.

The law does not apply to building permit requests. *Advantage Capital Mgmt. v. City of Northfield*, 664 N.W.2d 421 (Minn. App. 2003). The law also does not apply to the city or town subdivision regulation review process, review of local comprehensive plans by the Metropolitan Council, or the plat review process in Minnesota Statutes, chapter 505.

***When does the time begin to run?***

The 60 days begins to run when the agency receives a complete application. If an application needs to be amended, 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. 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. If an agency grants a conditional approval, the agency may revoke or rescind its approval without missing the 60-day deadline if the applicant fails to satisfy the conditions.

***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. The notice of extension must be made after the complete application is submitted and the initial 60 days has begun to run. An agency does not have to have extenuating circumstances to extend the review time; it is enough that the agency needs more time. *American Tower, L.P. v. City of Grant*, 636 N.W.2d 309, 313-314 (Minn. 2001). The law also takes into account other proceedings or federal law requirements that may delay the beginning of the 60-day period. An applicant may request an extension of time in writing.

***What constitutes approval or denial of a request?***

A request can be approved by the agency in its customary manner or by failing to deny the request within the 60-day period. An agency can only approve a request to the extent of its authority under other law. *Breza v. City of Minnetrista*, 725 N.W.2d 106 (Minn. 2006) ("The breadth of the exemption approved, however, is limited by the scope of the city's authority to grant an exemption...").

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. 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.

While failure to approve or deny a request results in approval, failure to timely provide the applicant with a written statement of the reasons for denial does not result in automatic approval. *Hans Hagen Homes, Inc. v. City of Minnetrista*, 728 N.W. 2d 536 (Minn. 2007) (city had stated reason for denial on the record within the time allowed).

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

**HOUSE RESEARCH** | **Short Subjects**

**Emily Cleveland** **October 2008**

# The Minnesota Newborn Screening Programs

The Minnesota Newborn Screening Programs are public health programs through which all infants born in the state are screened for a variety of disorders, including hearing loss. The Newborn Screening Program, which uses genetic information to screen for more than 50 disorders, is governed by Minnesota Statutes, sections 144.125 and 144.128. The Early Hearing Detection and Intervention programs, though which infants are tested for hearing loss, is governed by Minnesota Statutes, section 144.966.

***Infants are screened for more than 50 genetic disorders***

Under the Newborn Screening Program, hospitals and others in charge of caring for newborn infants are required to administer to every infant a test for heritable and congenital disorders. The Commissioner of Health determines the list of disorders for which infants are tested. Currently, the Department of Health (MDH) screens for more than 50 heritable and congenital disorders, including the following types:

- Amino acid disorders
- Fatty acid oxidation disorders
- Organic acid disorders
- Endocrine disorders
- Others including sickle cell disease and cystic fibrosis

Under this program, MDH has several duties to perform, including the following:

- notifying newborns' physicians of the results of the screen
- making referrals for the necessary treatment of diagnosed cases of heritable and congenital disorders when treatment is indicated
- maintaining a registry of the cases of disorders detected for the purpose of follow-up services

***The program was expanded to include screening for hearing loss***

In 2007, legislation was enacted that requires all hospitals to establish an Early Hearing Detection and Intervention (EHDI) program. Through their EHDI program, hospitals must:

- inform parents of the nature of the screening procedure, applicable costs, potential risks and effects of hearing loss, and the benefits of early detection and intervention;
- comply with the same parental consent requirements as is used for the other newborn screening program;
- train and monitor individuals responsible for performing hearing screening tests as recommended by MDH;
- test newborns prior to discharge or when medically feasible
- inform the infant's parents, primary care physician, and MDH of the results of the hearing screening test; and
- collect performance data specified by MDH.

***Parental consent to newborn screening is presumed unless parents object in writing***

Generally, consent for newborn screening is presumed unless the parent objects to the testing in writing. This has been referred to as an "opt-out" program because the infant will be screened unless parents specify in writing that they want their child to opt out of the screen. If a parent objects to newborn screening in writing prior to the screen, then the infant will not be screened.

Persons with a duty to perform testing under the Newborn Screening Program must inform parents of the following:

- that blood samples used to perform testing and the results of such testing may be retained by MDH
- that parents have the right to decline to have the tests, or to elect to have the tests but to require that all blood samples and records of test results be destroyed within 24 months of the testing

Also, adults who have been screened under this program may request that their stored blood spots and their test results be destroyed by filling out a destruction request form (available at the MDH web site). MDH must comply with a destruction request within 45 days after receiving it and notify individuals who request destruction of samples and test results that the samples and test results have been destroyed.

***The state's handling of genetic information is governed by law***

In 2006, legislation was passed that governs treatment of genetic information that is held by state government (Minn. Stat. § 13.386). This statute applies to genetic information collected on or after August 1, 2006 (Laws 2006, ch. 253, § 4).

Minnesota Statues, section 13.386, subdivision 3, requires that, unless provided in law, genetic information about an individual may be collected by the government with the written, informed consent of the individual. The genetic information may be used only for the purposes and stored for the period of time to which the individual consented. Also, the genetic information may be disseminated only with the individual's written, informed consent, or as necessary to accomplish the purposes of the collection.

In 2007, an administrative law judge found that the blood spots collected by MDH under the Newborn Screening Program fall under the definition of "genetic information," and that because the law governing how state government handles genetic information was passed after the law governing the Newborn Screening Program, MDH should handle the collection and storage of blood spots as required by Minnesota Statutes, section 13.386 and other state data handling laws. Legislation to exempt the Newborn Screening Program from the written, informed consent requirements of this law was considered in the 2008 legislative session, but did not become law.

**For more information:** Contact legislative analyst Emily Cleveland at 651-296-5808.

Nina Manzi & Randall Chun

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# 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 him or herself 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 2006, 58,135 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 2006, Minnesotans claimed $7.97 million of long-term care insurance credits. The average long-term care tax credit was $137 in tax year 2006. The average credit exceeds the maximum credit of $100 per qualified beneficiary because married couples filing joint returns may claim the maximum credit for both spouses (up to a total of $200).

***How does Minnesota compare with other states?***

This table includes all states that offered a long-term care insurance tax credit in 2006, but not those states that offer a long-term care insurance tax deduction. Data on number of claimants and cost by state is for 2006. In addition to the states listed, Mississippi and North Carolina have enacted credits that took effect in tax year 2007. Mississippi's credit equals to 25 percent of premiums with a maximum of $500, and North Carolina's equals 15 percent of premiums with a maximum of $350.

| | **Maximum credit** | **Credit rate*** | **Number of returns claiming the credit** | **Cost to the state for the credit** |
|---|---|---|---|---|
| **Colorado**[1] | $150 | 25% | not available | not available |
| **Maryland**[2] | Varies by age: $250-$500 | 100% | 8,210 | $3.62 million |
| **Minnesota** | $100 | 25% | 58,135 | $7.97 million |
| **Montana**[3] | $5,000 | Varies by income: 20% to 30% | 55 | $53,000 |
| **New York** | No maximum | 20% | 143,000 | $110 million |
| **North Dakota**[4] | $100 | 25% | 416 | $58,000 |
| **Oregon** | $500 | 15% | 26,353 | $5.8 million |

* The credit rate is the percentage of premiums allowed as a credit.

1 Colorado does not track the credit separately but instead combines it with other tax credits.

2 Maryland's credit can be claimed only once per person.

3 Montana's tax credit is a credit for expenses related to care of elderly family members. Long-term care insurance premiums are a qualifying expense. Data for Montana includes credits for all qualifying expenses, including long-term care insurance premiums.

4 North Dakota's tax credit is only available to filers who use the state's long form. Since tax rates on the short form are lower, only about 3 percent of taxpayers file using the long form.

**For more information:** Contact legislative analysts Nina Manzi at 651-296-5204, Joel Michael at 651-296-5057, or Randall Chun at 651-296-8639. (**Note:** Research assistant Anna Hovde provided help with this publication.)

HOUSE RESEARCH | Short Subjects

Steve Hinze and Karen Baker

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# 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 2009**

| 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 $890,000 | 0.50 | No | No |
| | Over $890,000 | 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 |
| 4d | Low-income apartments | 0.75 | No | Yes |

* 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 2009)**

| Property Type | Class Rate(s) | Net Tax Capacity | Property Tax* | | Effective Tax Rate |
|---|---|---|---|---|---|
| | | | Gross | Net | |
| Agricultural homestead** | 0.5/1.0% | $1,250 | $1,325 | $798 | 0.40% |
| 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 | 2,293 | 2,293 | 1.15 |
| Residential nonhomestead (1 unit) | 1.0 | 2,000 | 2,300 | 2,300 | 1.15 |
| Residential nonhomestead (2-3 units) | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Apartment | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Low-income apartment | 0.75 | 1,500 | 1,725 | 1,725 | 0.86 |
| Commercial/Industrial | 1.5/2.0 | 3,250 | 5,045 | 5,045 | 2.52 |
| Commercial/Industrial @ $2,000,000*** | 1.5/2.0 | 39,250 | 60,305 | 60,305 | 3.02 |

* These examples assume a total local net tax capacity tax rate of 100 percent, a state commercial-industrial tax rate of 46 percent, a state seasonal recreational tax rate of 19 percent, and 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.

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

Lisa Larson

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# Online Learning Option Act

***Minnesota school districts and charter schools may offer K-12 students online courses and earn additional revenue***

The Online Learning Option Act (Minn. Stat. § 124D.095) allows Minnesota school districts, intermediate districts, school districts operating under a joint powers agreement, and charter schools to offer online courses for credit to Minnesota K-12 public school students and some nonpublic students. Districts and charter schools providing online courses can earn additional state revenue for the online courses taken by students not enrolled in that district or charter school. Aid paid to a district or charter school enrolling a student is reduced and paid to another district or charter school providing online learning courses outside the enrolling district or charter school. State payments for online learning were $10,249,000 in fiscal year 2006, $16,580,000 in fiscal year 2007, and $24,898,000 in fiscal year 2008.

Nonpublic school students, including homeschool students who receive core curriculum instruction at a public school site, can generate shared time aid for online courses if they use computers at the public school (districts that provide instruction in core curriculum at a public school building to nonpublic school students are eligible to receive shared time aid).

Enrolling districts may proportionately reduce the classroom instruction of students taking online learning courses from an online learning provider. Online learning providers may limit student enrollment based on locally adopted acceptance standards. Out-of-state and nonschool district vendors cannot be online learning providers but may help providers design online courses. Districts and charter schools that provide online learning courses to their enrolled students do not receive online learning aid for those students.

***Online learning providers must offer rigorous courses aligned with academic standards and provide teacher contact time***

The state Department of Education must certify online learning providers and may charge providers a certification fee of up to $250. Online learning providers must offer:

- rigorous courses aligned with state academic standards that enable students to progress in a subject;
- online courses with standards or instruction, curriculum, and assessment requirements equivalent to other courses offered to enrolled students; and
- actual teacher contact time or other student-to-teacher communication.

Certified providers may receive payment for all online courses they offer unless challenged by an enrolling district or the department. The department must publish a list of certified online learning providers, courses, and programs.

***Students may take up to 50 percent of their courses per term online***

Minnesota K-12 public school students may apply to enroll in supplemental online learning courses offered in place of course periods during the regular school day or may apply to enroll full-time in an approved online learning program that offers comprehensive education and grade level advancement in some or all K-12 grades.

Students who take supplemental online learning courses must meet the grade level and graduation requirements of their enrolling district, which must transfer any of the student's earned academic credits for courses that meet or exceed local graduation standards and provide the student with nonacademic services. Students who enroll full-time do so under the state's open enrollment program or an agreement between school boards or in an online learning charter school.

Students under 18 must have their parents' permission to enroll and must give a reason for enrolling in online learning. Students do not need the permission of their enrolling district or charter school to take online learning courses given by another district or charter school. Online learning providers that accept nonenrolled students must notify the students and the students' enrolling district within ten days. The notice must include information about the online learning course content and assessment, academic credits, and start date, and confirm that the course meets the student's graduation plan. Accepted students and their parents must notify the online learning provider within ten days of the student's intent to enroll and must affirm that they understand the expectations of the course or program.

Enrolled students taking online learning courses:

- may take up to 50 percent of their full schedule of courses per term;
- must complete course work at a grade level commensurate with their ability; and
- may enroll in additional online courses under a separate fee agreement.

Students with disabilities may enroll in online courses consistent with their individualized education plan.

Districts and charter schools cannot discriminate against students taking online courses and must provide such students with the same access to computer hardware and education software as all other students. Online learning providers must help participating students whose families qualify for the education tax credit to acquire computer hardware and educational software. Nonpublic school students, students taking summer school classes, students enrolling in classes beyond full-time status, and students not residing in Minnesota are ineligible for public funding of online learning courses and programs. Students who do not qualify for public funding may enroll on a tuition basis with an online learning provider.

***Licensed Minnesota teachers deliver online learning***

Licensed Minnesota teachers must assemble and deliver instruction to students taking online learning courses. Teachers providing online learning instruction are limited to 40 students per course unless the commissioner of education waives this requirement. Actual teacher contact time or other similar communication is an expected online learning component.

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

Jeffrey Diebel

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# Predatory Offender Registration

***What is the predatory offender registration law?***

The predatory offender registration (POR) law is a system under which an individual convicted of a predatory offense (i.e., sex offense) is required to register with the Bureau of Criminal Apprehension (BCA) for a period of time, usually ten years. Minn. Stat. § 243.166. The law applies both to adults and juveniles and is designed to assist law enforcement in keeping track of predatory offenders and protecting public safety.

***Who must register?***

The POR law requires registration of individuals who have committed certain "predatory" crimes under Minnesota law, federal law, or the law of other states. The law also requires registration of individuals who have been civilly committed as sexually dangerous persons, sexual psychopathic personalities, or mentally ill and dangerous, provided the person was charged with one of the offenses listed below.

An offender must register under the law if charged with and convicted of one of the following offenses or another offense arising out of the same set of circumstances: murder while committing or attempting to commit criminal sexual conduct in the first or second degree with force or violence; kidnapping; criminal sexual conduct in the first, second, third, fourth, and fifth (felony only) degree; felony indecent exposure; false imprisonment of a minor; soliciting a minor to engage in prostitution or sexual conduct; using a minor in a sexual performance; and possessing pictorial representations of minors.

An offender who commits a "crime against the person" after previously commiting a predatory crime must also register. This provision requires offenders who committed their predatory crime prior to enactment of the POR law to register. Likewise, a person who was required to register in another state who has completed the registration requirements must register in Minnesota if the person commits a "crime against the person."

***What information must a predatory offender provide under the POR law?***

An individual who is required to register must provide the following information to the person's corrections agent or to law enforcement:

- the person's primary address
- all of the person's secondary addresses in Minnesota, including all addresses used for residential or recreational purposes
- the addresses of all Minnesota property owned, leased, or rented by the person
- the addresses of all locations where the person is employed
- the addresses of all schools where the person is enrolled
- the year, model, make, license plate number, and color of all motor vehicles owned or regularly driven by the person

***What if an offender is homeless?***

A person who is required to register but who does not have a primary address must register with the law enforcement authority that has jurisdiction in the area where he or she is staying within 24 hours after entering the jurisdiction. A homeless offender must provide law enforcement with a description of where he or she is staying with as much specificity as possible. A homeless offender shall report in person on a weekly basis to law enforcement.

***How does law enforcement know if a person is providing accurate information?***

The POR law aims to ensure information on offenders is current and accurate by requiring offenders to notify their corrections agents or law enforcement whenever any of their registration information changes. In addition, the BCA sends out verification letters to offenders annually. The offender must sign and return the form within ten days of receipt of the form, stating the offender's current and last address. For offenders who are required to register because they were committed as sexually dangerous persons or sexual psychopathic personalities, the BCA must verify residence four times a year. For level II and III offenders who are no longer under correctional supervision for a registration offense, the BCA must verify residence two times a year. In addition to these requirements, many local law enforcement agencies send police officers out to check on offenders in person to ensure they are living where they say they are.

***Is there a penalty for an offender's failure to follow the POR law?***

Yes. A person who knowingly violates any of the provisions of the registration law or who intentionally provides false information to a corrections agent, law enforcement authority, or the BCA is guilty of a five-year felony. The POR law provides a mandatory prison sentence of one year and one day for a first offense and not less than two years for a subsequent offense.

***For how long must an offender register?***

Except for those persons subject to lifetime registration, a person who is required to register is subject to the law for ten years from the time he or she initially registered in connection with the offense, or until the probation, supervised release, or conditional release period expires, **whichever occurs later**. For individuals who have been civilly committed, the ten-year registration period does not include the period of commitment. In addition, a new ten-year registration period applies to a person subsequently incarcerated following a conviction of a new offense or after a revocation of probation, supervised release, or conditional release for any offense. These individuals must continue to register until ten years have elapsed since they were last released from incarceration, or until their probation, supervised release, or conditional release expires, whichever occurs later.

***Who is subject to lifetime registration?***

Lifetime registration is required for three categories of individuals.

- **Recidivists.** This category includes a person convicted of or adjudicated delinquent for any offense for which registration is required who has a prior conviction or adjudication for an offense where registration was or would have been required under the law.
- **Individuals Who Commit Aggravated Offenses.** This category includes a person who commits a sexual act, including, but not limited to penetration, with a victim of any age through the use of force or the threat of serious violence and a person who commits a sexual act, including but not limited to penetration, with a victim under the age of 13.
- **Sexual Predators.** This category includes a person who is required to register following commitment as a sexual psychopathic personality or sexually dangerous person.

**For more information:** Contact legislative analyst Jeffrey Diebel. Also see the House Research publication *Sex Offenders and Predatory Offenders: Minnesota Criminal and Civil Regulatory Laws*.

**HOUSE RESEARCH** | **Short Subjects**

**Matt Gehring** **November 2008**

# Election Recounts: Federal, State, and Judicial Offices

***Types of Recounts Permitted in Minnesota***

An **automatic recount** of the results of an election for federal office, state constitutional or legislative office, or judicial office will occur if the difference in the number of votes cast for the apparent winning candidate and any other candidate is less than one half of 1 percent (0.5 percent). An automatic recount will also occur where the difference in votes cast is ten votes or less and the total number of votes cast for an office is 400 or fewer.

The apparent losing candidate is permitted to waive an automatic recount by filing a notice with the state canvassing board.

A **discretionary recount** of the results of an election for federal office, state constitutional or legislative office, or judicial office can also occur if the difference in the number of votes cast for the apparent winning candidate and any other candidate is one half of 1 percent (0.5 percent) or greater. A discretionary recount will only take place upon the request of an apparent losing candidate in that election. A request for a discretionary recount must be submitted within five days of the canvass of a primary election, or within seven days of the canvass of a general election.

A candidate who requests a discretionary recount may specify up to three precincts to be recounted first; the candidate may waive the remainder of the recount after the specified precincts are recounted.

***State Canvassing Board***

The State Canvassing Board is responsible for final certification of the results of an election, regardless of whether a recount is conducted. In a recount, the board is also responsible for reviewing and determining whether a challenged ballot will be included in the final election results.

The State Canvassing Board consists of the secretary of state, two justices of the Minnesota Supreme Court, and two judges of a Minnesota district court. The judges are selected by the secretary of state. A judge may not serve on the canvassing board if the judge is simultaneously a candidate in the election.

***Conduct of Recount***

Minnesota law requires all recounts to be conducted by hand. During the recount, each ballot is manually inspected. If the intent of the voter can be discerned, a vote is counted for the appropriate candidate. State law establishes 15 principles for determining a voter's intent, which must be followed by the recount officials. The official may only determine intent based upon inspection of the markings on the ballot.

In conducting a recount, only the specific race on the ballot being recounted is reviewed. Recount officials review the ballot markings only and do not consider voter eligibility, absentee ballot status, or other aspects of election law.

By rule, ballots are recounted by precinct. More than one precinct may be recounted at a time, provided that the ballots from each precinct remain physically segregated.

A candidate or a candidate's representative may be present while a recount is being conducted. Members of the public may also observe the recount process. Candidates, representatives, or other members of the public are prohibited from handling ballots or other election materials.

If the candidate or representative of the candidate disagrees with the recount official's determination of intent, the ballot may be challenged. A challenge may not be made automatically or frivolously. The precinct name, basis for the challenge, and the name of the person making the challenge is recorded on the back of the ballot. Challenged ballots are placed in a separate envelope.

Upon completion of the full recount, challenged ballots are presented to the canvassing board. The canvassing board will review each ballot, hear the basis for the challenge if the challenger is present, and issue a ruling as to the final disposition of the ballot.

***Results of a Recount***

The vote totals for each candidate following a recount may be different—in some cases, substantially—from the unofficial results reported on election night. This is often because the recount will turn up ballots that reveal a voter's intent, but were unable to be read by an optical-scan voting machine. For example, optical-scan voting machines do not register a vote if the voter circles a candidate's name instead of filling in the oval next to the name; provided the intent is clear upon manual inspection of the ballot, however, the vote is counted as a part of the recount.

The final results as modified, if necessary, by the recount are considered the final results of the election and are certified as final by the canvassing board.

***Tie Votes***

If, even after a recount, the results of an election show that two candidates have an equal number of votes, Minnesota law requires that the canvassing board choose the winner by lot.

***Recount Expenses***

The governing body responsible for conducting an automatic recount is also responsible for the expenses of the recount.

A candidate who requests a discretionary recount is responsible for the expenses of the recount. At the time a candidate requests a recount, the candidate must file a security deposit in an amount determined by the election official to cover the recount expenses.

If the results of a discretionary recount overturn the apparent results of the election, the governing body conducting the recount becomes responsible for the recount expenses. A governing body also becomes responsible for recount expenses if the manual recount results differ from the results reported on election day by a margin greater than one half of 1 percent, even if the winning candidate does not change following the recount.

**For more information:** Contact legislative analyst Matt Gehring at 651-296-5052.

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

**Mark Shepard**

**Updated: November 2008**

# Gift Ban Law and Rules for House Members and Employees

***What does the gift ban law prohibit?***

Legislators and legislative employees must not request or accept a gift from a lobbyist or principal, and lobbyists and principals must not give a gift to a legislator or legislative employee or ask someone else to do so. 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 with a resale value of $5 or less
- 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 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 for-profit 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 Mark Shepard at 651-296-5051.

Joel Michael

Updated: November 2008

# 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;
- Derive 80 percent or more of its gross income from active foreign business income or be a 936 corporation (i.e., a corporation deriving 80 percent of its income from U.S. possessions, such as Puerto Rico); and
- Not be a foreign sales corporation (FSC) or an interest charge domestic international sales corporation (DSC). FSCs and DSCs were formed under a now obsolete federal tax provisions 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. It does not apply to income derived from U.S. sources as defined under the federal tax law (subchapter N of the Internal Revenue Code). This subtraction also applies to payments from true foreign corporations.

Thus, most of 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* (2008) estimates that FOC and related provisions reduce corporate franchise tax collections by about $180 million per year. However, the 2008 legislative changes reduced these amounts significantly (by about $90 million per year). As a result, the revised foreign source income provisions likely reduce corporate revenues by about $90 million to $95 million per year. Total corporate tax revenues are about $1 billion per year, based on the February 2008 forecast.

*When were the FOC provisions adopted?*

The FOC provisions were adopted by the 1988 Legislature and remained largely unchanged until the 2008 Legislature based the definition of FOCs on the income sources of the corporation (i.e., requiring 80 percent of its income to be foreign source). Prior to that, the test was based on the location of the corporation's property and payroll factors.

*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 take 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.

***What was the rationale for the 2008 legislative changes?***

Starting in the late 1990s, legislators became concerned that some corporations were abusing the FOC provisions by shifting income from their domestic operations into FOCs. (The structure and literal language of the provisions allowed this.) Corporations typically did this by assigning intangible property to their FOCs. The income (royalties, fees, interest, and so forth) received for use of the intangibles could be from domestic sources and still qualify for the 80 percent discount on taxes, if the FOC met the factor test. To compound this, the charges for use of these intangibles were typically paid by other members of the unitary group. This allowed businesses to use "transfer pricing" practices to shift additional income into their FOCs. These prices didn't matter to the businesses, since they were doing little more than shifting money from one part of the business to another. However, by maximizing the amount of income in FOCs, overall Minnesota tax was minimized.

The 2008 legislation attempted to foreclose these possibilities by requiring an FOC's income to be derived 80 percent from foreign sources, as determined under federal tax rules. However, this does not fully eliminate the possibilities for abuse. Federal definitions of foreign versus domestic income also depend upon accurate transfer pricing. Federal tax officials have expressed concerns regarding their ability to prevent taxpayers from recharacterizing or artificially shifting income to foreign countries with lower tax rates through transfer pricing practices. This type of federal tax avoidance or evasion may now directly affect Minnesota tax liability.

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

# HOUSE RESEARCH | Short Subjects

Steve Hinze and Karen Baker

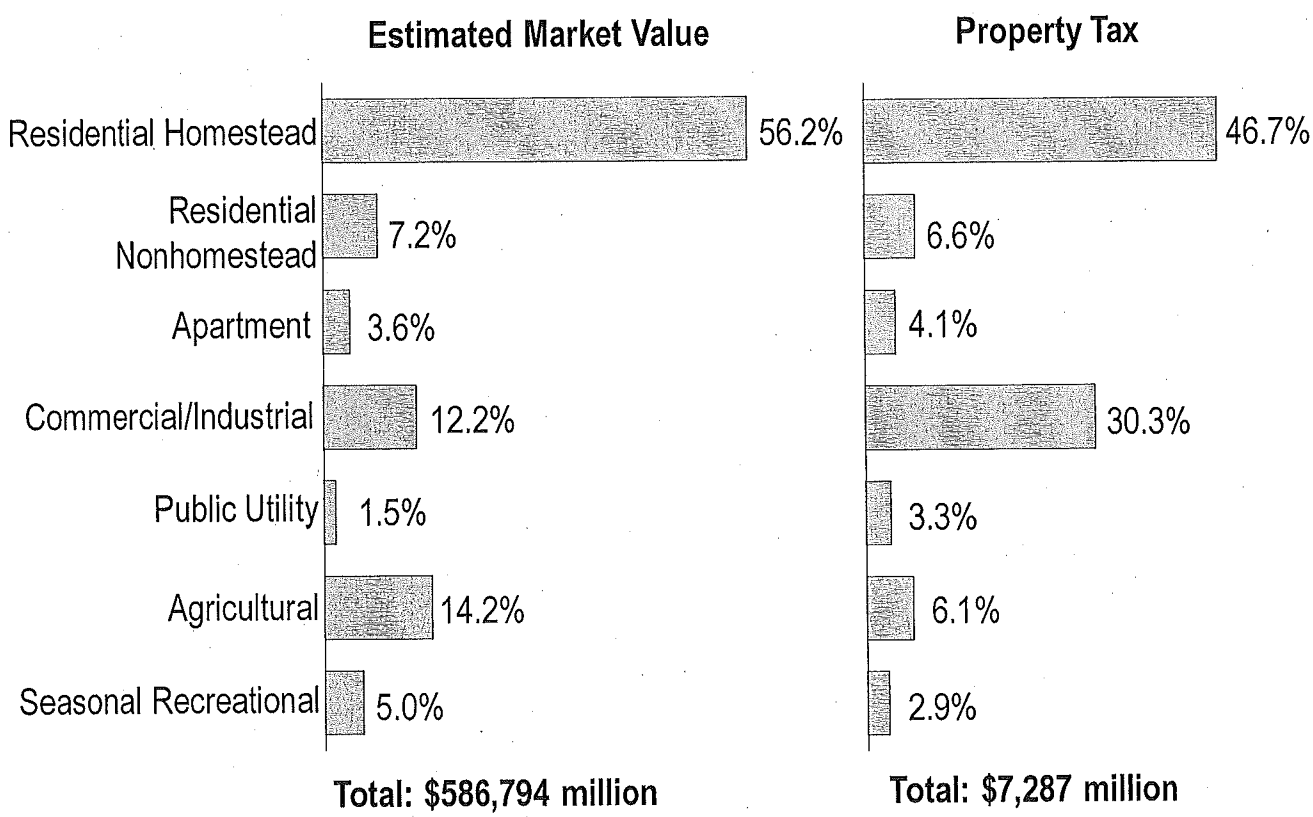
Updated: October 2008

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

*Where property taxes come from*

Total property taxes statewide were $7,287 million for calendar year 2008. The total amount of property value (excluding the value of exempt property) was $586,794 million. The graphs below show the breakdown of the state's total property tax base by market value and by taxes paid in 2008.

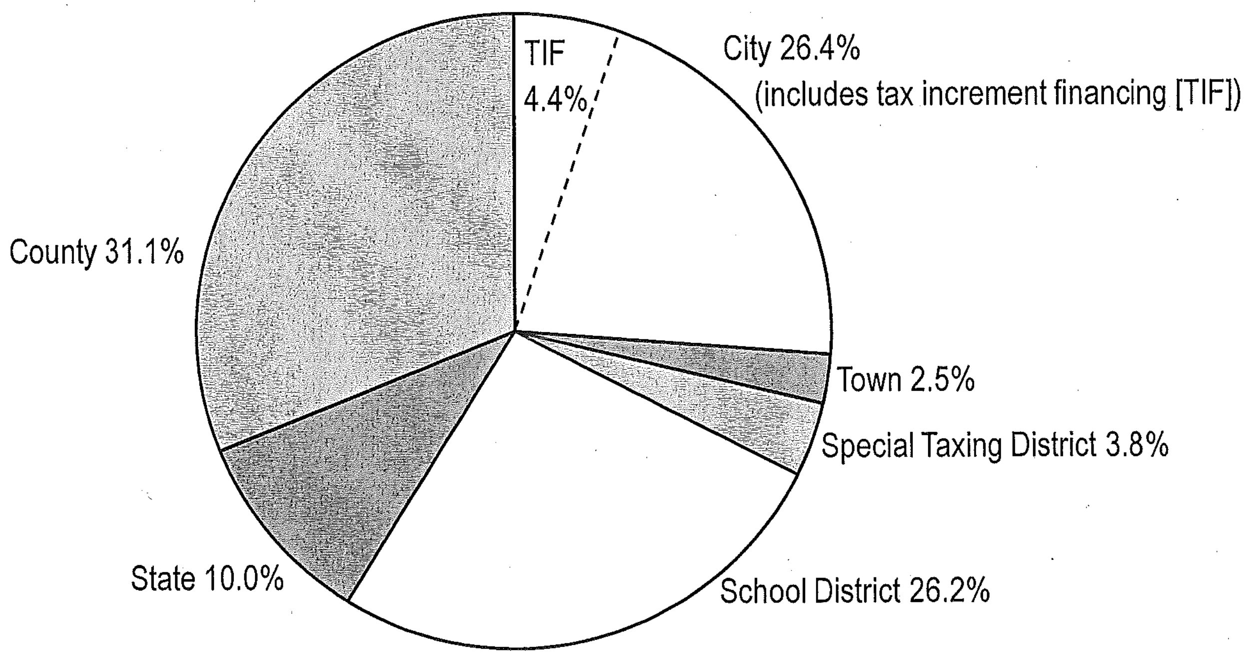
**Statewide Shares of Market Value and Property Tax by Property Type (taxes payable 2008)**



*Where property taxes go*

The total property tax burden in Minnesota was $7,287 million for calendar year 2008. 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 2008**
**(Total: $7,287 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.

**Randall Chun** **Revised: November 2008**

# General Assistance Medical Care: An Overview

General Assistance Medical Care (GAMC) is a state-funded program that pays for certain health care services for low-income Minnesota residents who are not eligible for other health care programs. Most GAMC enrollees are low-income adults between the ages of 21 and 64 who do not have dependent children. The program is administered locally by the counties, under the supervision of the Department of Human Services (DHS), and is governed by Minnesota Statutes, section 256D.03.

***Eligibility***

To be eligible for GAMC, an individual must meet the following criteria:

- Receive General Assistance (GA) or Group Residential Housing (GRH), or meet the GAMC income and asset limits and be exempt from enrollment in MinnesotaCare (see table below)
- Not be eligible for Medical Assistance (MA)
- Be a Minnesota resident; GAMC has a 30-day durational residency requirement
- Meet other program eligibility requirements

| Eligibility Group | Income Limit | Asset Limit* | Covered Services | Cost-Sharing |
|---|---|---|---|---|
| 1. GA and GRH recipients | GA limit ($203/ month for one person; $260 for married couple) or GRH assistance standard | GA limit ($1,000 per assistance unit) or GRH limit ($2,000 aged, blind, or disabled; $1,000 all others) | All covered services | Copayments |
| 2. GAMC full coverage | 75 percent of federal poverty guidelines (FPG) | $1,000 per household | All covered services | Copayments |
| 3. GAMC hospital-only coverage | Greater than 75 percent but not exceeding 175 percent of FPG | $10,000 per household of one/$20,000 per household of two or more | Inpatient hospital services and physician services provided during inpatient stay | $1,000 deductible for each hospitalization |

* The homestead, household goods, a vehicle, and other specified items are not counted as assets.

Since September 1, 2006, certain GAMC applicants and recipients have been enrolled in MinnesotaCare as adults without children, immediately following approval of GAMC coverage. GAMC applicants and enrollees who are eligible due to receipt of GA or GRH, are awaiting a determination of disability, who do not meet the MinnesotaCare residency requirement specified, or belong to other groups are exempt from this enrollment requirement.

***Covered services***

GAMC covers a range of medical services for individuals with incomes not exceeding 75 percent of federal poverty guidelines (FPG). These include, but are not limited to, physician care, hospitalization, rehabilitation, dental, medical equipment and supplies, mental health, prescription drugs, and medical transportation.

Services not covered include: home health care services, nursing home services, therapy services provided by independently enrolled providers, pregnancy and related services (GAMC enrollees who are pregnant qualify for coverage of these services under MA and/or Emergency MA), and services in an intermediate care facility for persons with mental retardation and related conditions (ICF/MR).

Covered services for enrollees with incomes greater than 75 percent but not exceeding 175 percent of FPG are limited to inpatient hospital services and physician services provided during an inpatient stay.

***Cost-sharing***

Enrollees with incomes at or below 75 percent of FPG are subject to the following copayments:

- $25 for eyeglasses
- $25 for nonemergency visits to an emergency room
- $3 per brand-name prescription and $1 per generic, subject to a $12-per-month limit. Antipsychotic drugs are exempt from copayments.
- 50 percent coinsurance for basic restorative dental services

Enrollees with incomes greater than 75 percent but not exceeding 175 percent of FPG are subject to a $1,000 deductible for each inpatient hospitalization.

***Provider reimbursement***

The GAMC program reimburses providers under both a fee-for-service system and a managed care system (composed of prepaid GAMC and county-based purchasing initiatives). Under the fee-for-service system, health care providers bill DHS and are reimbursed at rates specified by state law. Under managed care, prepaid health plans (or counties in the case of county-based purchasing) receive a monthly capitation payment for each enrollee. The state does not set provider reimbursement rates; these rates are instead the result of negotiation between the health care providers and the prepaid health plan or county.

***Funding and expenditures***

GAMC is completely state-funded; there is no federal funding. During fiscal year 2007, the state spent $281.1 million in payments to medical providers for GAMC services.

***Recipients***

In fiscal year 2007, an average of 33,824 persons were eligible for GAMC services each month. As of August 2008, 16,977 GAMC recipients were enrolled in prepaid GAMC or a county-based purchasing initiative.

***Application procedure***

Individuals interested in applying for GAMC should contact their county human services agency.

**For more information:** See the House Research information brief *General Assistance Medical Care*, October 2008.

HOUSE RESEARCH | Short Subjects

Jeffrey Diebel

Updated: November 2008

# Minnesota's Predatory Offender Community Notification Law

***What is community notification?***

Minnesota's community notification law requires assignment of risk levels to predatory offenders (i.e., sex offenders) who serve time in prison and are required to register under Minnesota's predatory offender registration law after their release. (Predatory offenders who serve their time in a county jail are not assigned a risk level and are not subject to the community notification law.) Based upon the risk level assigned to the offender, law enforcement must share certain information and may share other information about the offender with certain individuals and entities in the area where the offender lives, works, or attends school. This law aims to increase public safety by letting people know where these offenders are in the community.

***Who is a predatory offender?***

A predatory offender is an offender who is required to register under the predatory offender registration law, except for individuals who are required to register solely because of a juvenile delinquency determination. A person is treated as a predatory offender if the person has committed felony criminal sexual conduct or certain other designated sex crimes, kidnapping, or false imprisonment. These crimes are often referred to as predatory offenses. The law recognizes as predatory offenders those individuals who have committed these crimes under Minnesota law, federal law, or the law of other states. The law also requires registration of certain individuals who have been civilly committed as sexually dangerous persons or as mentally ill and dangerous, provided the person was charged with a predatory offense.

***What are the various risk levels and what do they mean?***

There are three risk levels, as follows:

- **Level I** offenders have a risk assessment score that indicates a low risk of reoffense.
- **Level II** offenders have a risk assessment score that indicates a moderate risk of reoffense.
- **Level III** offenders have a risk assessment score that indicates a high risk of reoffense.

***What type of community notification occurs for the various risk levels?***

The type of community notification that occurs depends on the risk level to which an offender has been assigned. The depth and breadth of the disclosure depends upon the level of danger posed by the offender, his or her pattern of offending behavior, and the need of community members for information to enhance individual and community safety. Notification for the three levels is as follows:

**Level I Offenders.** The law enforcement agency may maintain information about the offender within the agency and disclose it to other law enforcement agencies. The law enforcement agency also may disclose the information to any victims or witnesses to the offense committed by the offender. The agency must disclose information to victims of the offense who have requested disclosure and to adult members of the offender's immediate household.

**Level II Offenders.** The law enforcement agency may disclose the same information it may disclose on Level I offenders and it also may disclose information to agencies and groups the offender is likely to encounter. These agencies and groups include the staff members of public and private educational institutions, day care establishments, and establishments and organizations that primarily serve individuals likely to be victimized by the offender. The agency also may disclose information to individuals the agency believes are likely to be victimized by the offender based on the offender's pattern of offending or victim preference.

**Level III Offenders.** The law enforcement agency must disclose the information to the persons and entities who may receive notice about Level I and II offenders. When the notified entity is one that primarily educates or serves children, and the offender is participating in programs offered by the facility that require or allow the person to interact with children, then the entity must notify parents with children at the facility. In addition, the agency must disclose information to other members of the community whom the offender is likely to encounter, unless the agency determines that public safety would be compromised by the disclosure or that a more limited disclosure is necessary to protect the identity of the victim. When a Level III offender moves into a community, law enforcement typically holds a community meeting to provide information about the offender. The offender may not attend the meeting.

***Are predatory offenders "wanted" by the police?***

Generally, no. Community notification is not part of the offender's punishment for an offense. Most sex offenders residing in the community have served the prison or jail time imposed on them and have been properly released to live in the community. Although many of these offenders are still under some form of correctional supervision (i.e., probation or supervised release), some are not.

***How can I obtain information about Level III offenders living in my community?***

Information about Level III offenders is posted on the Department of Corrections web site at www.doc.state.mn.us/level3/search.asp. Your local law enforcement agency also may be able to provide you with information. Information on Level I and II offenders is generally not public and is only made available to law enforcement and persons and entities identified above.

**For more information:** See the House Research publication *Sex Offenders and Predatory Offenders: Minnesota Criminal and Civil Regulatory Laws.*

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 Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: November 2008

# TIF Duration Extensions to Offset Deficits

***Tax reform reduced increments, making some districts unable to pay their debt in full***

The 2001 property tax reform reduced the increments of tax increment financing (TIF) districts. In some cases, these reductions were sufficiently large that some TIF districts no longer generated enough increments to pay their obligations (bonds or development contracts). The 2001-02 legislature provided a variety of tools to help address these deficits or shortfalls. (*See* House Research, *TIF: Deficit Reduction Provisions*, January 2008, for the general description of these mechanisms.)

***The 2003 Legislature authorized extensions to offset deficits***

In 2003, the legislature authorized development authorities and cities to extend the duration of TIF districts beyond the normally applicable legal duration limits. This will permit the development authority (e.g., an HRA or EDA) to collect increments for a longer period of time, providing more increment to pay the TIF obligations. This additional increment, of course, will not be received until after the end of the normal duration of the district and, thus, cannot help to pay current debt service obligations. But if an extension can be combined with a refinancing of the TIF debt, it may enable current debt obligations to be met.

***Which districts qualify to be extended?***

To qualify for an extension, a district must meet three tests:

- Certification of the district must have been requested before August 1, 2001 (i.e., before enactment of the 2001 property tax reform).
- The district's increments must be pledged to pay bonds, interfund loans (i.e., loans made by the city or authority from one of its non-TIF funds), or developer agreements that were entered before August 1, 2001.
- The authority must have used all of the other available deficit reduction measures to eliminate the deficit including:
  - Uncapping the original tax rate;
  - Switching fiscal disparities options; and
  - Transferring (or pooling) available increments from other districts.

***How long is the permitted extension?***

The length of the permitted duration extension is determined under a formula that is an estimate of the reduction in the increment that was caused by the 2001 property tax reform. The formula extension is computed by comparing the tax paid by the district's original net tax capacity in 2001 with its average tax paid in 2002 and 2003. (The state general tax and market value taxes are ignored in these computations, since they do not affect increment computations.) The percentage reduction is multiplied by the remaining duration of the district (as of December 31, 2001) to determine the permitted extension (rounded up to the nearest whole number of years for fractional amounts greater than one-third). For example, a district with nine years remaining that experienced a 25-percent drop in taxes on its original net tax capacity would qualify for a two-year extension (9 years x 25% = 2.25 years or rounded to two years). The maximum extension cannot exceed four years, in any case.

***DOR may grant an additional extension***

If the city estimates that the formula extension will not provide enough additional increment to pay the obligations in full, it may apply to the Department of Revenue (DOR) for an additional extension of up to two years. DOR received an application for an extension in 2004, which it approved. That is the only request it has received.

***Special rules for developer or "pay-as-you-go" obligations***

The extension authority was primarily intended to help the development authority or municipality to pay its own obligations—i.e., the reduction created a shortfall, relative to the authority's legal obligation to pay. This situation generally does not occur with developer obligations (commonly referred to as "pay-as-you-go" obligations). Under pay-as-you-go contracts, the authority's obligation is limited to the amount of its available increment. Thus, from the authority's perspective, even though increments may have dropped substantially, there isn't a deficit; the authority is only obligated to pay over whatever increments it receives. However, the developer expected to receive higher payments based on the pre-2001 property tax system and, thus, often will not receive payments that are large enough to cover the costs identified in the agreements with the city or authority. In some instances, these obligations or notes were sold to third-party investors who now suffer the loss. To provide some relief for these developers and investors, the extension law allows the authority to treat a pay-as-you-go obligation as a qualified obligation. If it does so, the maximum extension is one-half the regular formula amount (e.g., it cannot exceed two years). Also, application may not be made to DOR for an additional two-year extension.

***Restrictions applicable to extended districts***

If an authority elects to extend the duration of a district, after approval of the extension it can only use increments from the district to pay pre-existing obligations (i.e., those issued before August 1, 2001). The purpose of this restriction is to prevent the use of increments from the extension to fund new costs. During the extension period, increments may only be used to pay qualifying obligations (i.e., pre-2001 bonds, interfund loans, and pay-as-you-go notes). If increments from multiple districts are pledged to pay the qualifying obligations, then all of these districts (even if their terms have not been extended) are subject to this limit on the use of increments.

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *TIF Deficit Reduction Provisions*, January 2008.

**HOUSE RESEARCH** | **Short Subjects**

**Nina Manzi**

**Updated: November 2008**

# The Minnesota and Federal Dependent Care Tax Credits: An Overview

***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 2009, the state phaseout begins when income exceeds $23,330, and the state credit is fully phased out when income exceeds $36,980. 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 2006, 145,206 Minnesotans claimed the federal dependent care credit and 35,777 claimed the state credit. These claims represent 5.7 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 2006 was only available to filers with incomes below $34,710, most of the state credits are claimed by low-income filers.

***How much is paid out in credits?***

In tax year 2006, Minnesotans claimed $64.8 million of federal dependent care credits. The average federal dependent care credit was $446.

In tax year 2006, Minnesotans claimed $13.7 million of state dependent care credits. The average state dependent care credit was $383.

***How are the credits distributed geographically?***

While about 43 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 2006 nonmetro filers were more likely to claim the credit than were metro area filers.

***How does Minnesota compare with other states?***

Nationwide, 4.6 percent of all income tax returns claimed the federal dependent care credit, compared to 5.7 percent in Minnesota. Maryland had the highest percentage of returns claiming the federal credit at 6.5 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 2006 was $531; it was $446 in Minnesota. The District of Columbia had the highest average credit at $628, and Montana had the lowest at $415. 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*, December 2008.

Nina Manzi

Updated: November 2008

# The Federal Earned Income Tax Credit and Minnesota Working Family Credit: An Overview

***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 2009, individuals with more than $3,100 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 2009, 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 | $457 | $114 | $7,470 | $7,460 | $13,440 | $13,440 |
| 1 child | $3,043 | $911 | $16,420 | $19,510 | $35,463 | $35,412 |
| 2 or more children | $5,028 | $1,759 | $16,420 | $23,140 | $40,295 | $40,218 |
| *Married claimants* | | | | | | |
| No children | $457 | $114 | $10,600 | $10,590 | $16,570 | $16,570 |
| 1 child | $3,043 | $911 | $19,550 | $22,640 | $38,593 | $38,542 |
| 2 or more children | $5,028 | $1,759 | $19,550 | $26,270 | $43,425 | $43,348 |

***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 2006, 281,927 Minnesota returns claimed the EITC and 267,603 claimed the WFC. These claims represent 11.0 percent of all federal returns filed by Minnesotans and 10.6 percent of all state returns filed.

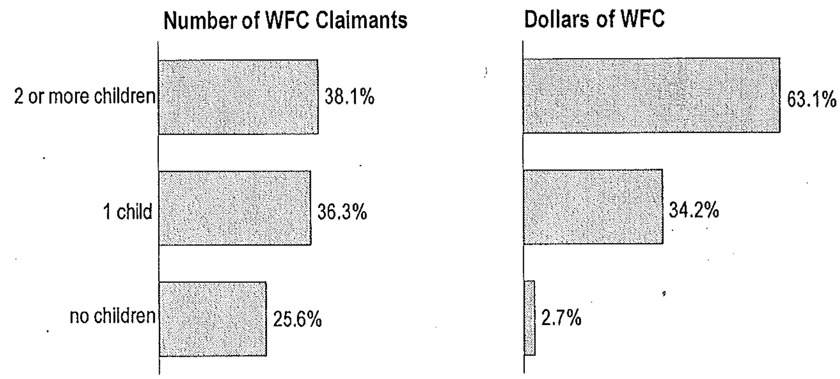
***How much is paid out in credits?***

In tax year 2006, Minnesotans claimed $474 million in EITC, of which $60 million offset tax liability and the remaining $414 million was paid as a refund. The average EITC was $1,682.

Minnesotans claimed an additional $147 million in WFC, of which $26 million offset tax liability and the remaining $121 million was paid as a refund. The average WFC was $550.

***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 2006. Individuals without children filed 25.6 percent of returns claiming credits, but received only 2.7 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 2006 nonmetro filers were more likely to claim the credit than were metro area filers.

***How does Minnesota compare with other states?***

Nationwide, 16.6 percent of all income tax returns claimed the EITC, compared to 11.0 percent in Minnesota. The average EITC nationwide in 2006 was $1,932; it was $1,682 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

Twenty-three other states and the District of Columbia have enacted 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*, December 2007.

Nina Manzi & Joel Michael

Updated: November 2008

# 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.
- **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, the military service combat zone 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 8 percent for 2008 and 5 percent for 2009.

*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.

Nina Manzi & Joel Michael

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# 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?***

Minnesota's AMT roughly follows the federal AMT. Both follow the model of requiring taxpayers to compute a tentative 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 the 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.

***Who pays the AMT?***

AMT filers fall into three main groups:

- Those who have large 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
- Taxpayers with income above the level at which the AMT exemption is fully phased out

***How are the federal and state AMTs different?***

The federal and state AMTs have two major differences. The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not. Also, the Minnesota AMT has one flat rate; the federal tax, by contrast, has two rates.

***What are the recent changes to the Minnesota AMT?***

Since tax year 2006, the Minnesota AMT has allowed 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 increased to $60,000 for married joint filers and $45,000 for single filers. It is adjusted annually for inflation and is $66,480 for married joint filers and $49,860 for single filers in tax year 2009.

***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 2009 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<br>Incentive stock options<br>Depletion<br>Intangible drilling costs<br>Tax-exempt interest from private activity bonds |
| **Standard deduction** | $11,400 (married joint) | $66,480 for married joint (phased out for taxpayers with income from $150,000 to $415,920) |
| **Personal exemptions** | $3,650 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 $34.8 million in tax year 2009, from about 19,400 taxpayers. The amount of revenue and the number of taxpayers paying the AMT are expected to increase in future years. Although the exemption is indexed annually for inflation the AMT will tend to increase as real income increases, and as AMT preference items, such as home mortgage interest and property taxes, increase more rapidly than 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: November 2008

# 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 (FAGI) 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 FAGI?***

FAGI 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 FAGI 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 FAGI). FAGI does not include child support received by the taxpayer.

***What kinds of income are excluded from FAGI?***

FAGI 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); penalty on early withdrawal of savings; alimony paid by the taxpayer; for tax year 2008 only, the first $500 of property taxes paid by standard deduction filers ($1,000 for married joint filers); and, through tax year 2009, $250 of teacher classroom expenses and $4,000 of tuition expenses for higher education. 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 2006, the most recent year for which data is available, 54 percent of Minnesotans claimed the standard deduction and 46 percent itemized.

***How much is the standard deduction?***

In tax year 2009, the standard deduction is as follows:

- $11,400 for married couples filing joint returns
- $5,700 for married couples filing separate returns
- $8,350 for head of household filers
- $5,700 for single filers

***What itemized deductions are allowed?***

Itemized deductions are allowed for the following:

- Payments of state and local property taxes and income taxes
- Mortgage 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 2009, the personal and dependent exemptions are $3,650 each. A family of four qualifies for four exemptions, totaling $14,600.

***Are there limits on deductions and exemptions?***

Itemized deductions are limited for taxpayers with incomes over a threshold. This limit takes away some of the benefit of the deduction for higher income taxpayers. Taxpayers subject to the limit (see table below) have their deductions reduced by 3 percent of their AGI over the applicable thresholds. But they are always guaranteed 20 percent of the deductions, no matter how high their AGIs are.

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 2009 | Itemized deduction limit begins at | Exemption phaseout begins at |
|---|---|---|
| **Married joint filers** | $166,800 | $250,200 |
| **Married separate filers** | $83,400 | $125,100 |
| **Single filers** | $166,800 | $166,800 |
| **Head of household filers** | $166,800 | $208,500 |

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 2009, the limitation and the phaseout will be reduced by two-thirds. 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 2007.

**Karen Baker and Nina Manzi**

**Updated: December 2008**

# 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.

***What are recent changes to the program?***

The 2008 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2009. The changes lowered the maximum threshold percentage for determining eligibility from 4.0 percent of income to 3.5 percent of income, and increased the maximum refund allowed from $1,800 to $2,310.

***What are the maximums?***

For refund claims filed in 2009, based on property taxes payable in 2009 and 2008 household income, the maximum refund is $2,310. Homeowners whose income exceeds $96,939 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, 2009, will be paid beginning in late September 2009. The deadline for filing claims based on taxes payable in 2009 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

***What is the average refund and total amount paid?***

**Statewide Homeowner Property Tax Refunds Filed in 2007**
**(based on 2006 incomes and payable 2007 taxes, most recent data available)**

| | Number of returns | Total refund amount | Average per return |
|---|---|---|---|
| Under 65 years old | 198,206 | $132.0 million | $667 |
| Senior/disabled | 120,691 | $80.9 million | $670 |
| Total: all homeowners | 318,897 | $212.9 million | $668 |

***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 2009 property taxes of $3,125, a typical amount for the metro. The family in greater Minnesota has payable 2009 property taxes of $1,580, a typical amount 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**
**Example refunds for claims to be filed in 2009,**
**based on taxes payable in 2009 and 2008 income**

| | | **Metro area** | | **Greater Minnesota** | |
|---|---|---|---|---|---|
| | | **Taxpayer #1** | **Taxpayer #2** | **Taxpayer #3** | **Taxpayer #4** |
| 1 | Estimated average market value of home | $280,000 | $280,000 | $165,000 | $165,000 |
| 2 | Gross income | $25,000 | $50,000 | $25,000 | $50,000 |
| 3 | Deduction for dependents | $9,450 | $9,450 | $9,450 | $9,450 |
| 4 | Household income (2 – 3 = 4) | $15,550 | $40,550 | $15,550 | $40,550 |
| 5 | Property tax | $3,125 | $3,125 | $1,580 | $1,580 |
| 6 | Statutory threshold percentage | 1.9% | 2.7% | 1.9% | 2.7% |
| 7 | Threshold % x income (4 x 6 = 7) | $295 | $1,095 | $295 | $1,095 |
| 8 | Property tax over threshold (5 – 7 = 8) | $2,830 | $2,030 | $1,285 | $485 |
| 9 | Statutory copay percentage | 30% | 40% | 30% | 40% |
| 10 | Taxpayer copay amount (8 x 9 = 10) | $849 | $812 | $385 | $194 |
| 11 | Remaining tax over threshold (8 – 10 = 11) | $1,981 | $1,218 | $899 | $291 |
| 12 | Maximum refund allowed | $2,010 | $1,700 | $2,010 | $1,700 |
| 13 | Net property tax refund | $1,981 | $1,218 | $899 | $291 |

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us.

Nina Manzi and Karen Baker

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# 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 2009, based on rent paid in 2008 and 2008 household income, the maximum refund is $1,490. Renters whose income exceeds $52,299 are not eligible for refunds.

***How are claims filed?***

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2009, will be paid beginning in August 2009. The deadline for filing claims based on rent paid in 2008 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

***What is the average refund and total amount paid?***

**Statewide Renter Property Tax Refunds Filed in 2007**
**(based on 2006 incomes and rent paid in 2006, most recent data available)**

| | Number of returns | Total amount | Average per return |
|---|---|---|---|
| Under 65 years old | 196,738 | $104.3 million | $530 |
| Senior/disabled | 77,051 | $46.3 million | $601 |
| Total: all renters | 273,789 | $150.6 million | $550 |

***How do refunds vary depending on income and 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 2008 of $699, the fair market rent for a one-bedroom apartment in the metro area. (19% of $707 x 12 = $1,594, which is their rent constituting property tax.) The family in greater Minnesota paid monthly rent in 2008 of $444, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. (19% of $433 x 12 = $1,012, 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**
**Example refunds for claims to be filed in 2009,**
**based on rent paid in 2008 and 2008 income**

| | | **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 | $1,594 | $1,594 | $1,012 | $1,012 |
| 5 | Statutory threshold percentage | 1.4% | 2.4% | 1.4% | 2.4% |
| 6 | Threshold % x income (3 x 5 = 6) | $210 | $720 | $210 | $720 |
| 7 | Property tax over threshold (4 – 6 = 7) | $1,384 | $874 | $802 | $292 |
| 8 | Copay percentage | 20% | 30% | 20% | 30% |
| 9 | Taxpayer copay amount (7 x 8 = 9) | $277 | $262 | $160 | $88 |
| 10 | Remaining tax over threshold (7 – 9 = 10) | $1,107 | $612 | $642 | $205 |
| 11 | Maximum refund allowed | $1,490 | $1,490 | $1,490 | $1,490 |
| 12 | Net property tax refund | $1,107 | $612 | $642 | $205 |

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us.

HOUSE RESEARCH | Short Subjects

Karen Baker and Nina Manzi

Updated: December 2008

# 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 of the previous year's tax or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated.

| | |
|---|---|
| Payable 2008 Property Tax<br>Payable 2009 Property Tax | $1,400<br>2,000 |
| 2009 tax increase (over 2008)<br>Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x 1,400) | $600<br><br>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 2009 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 2009 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 25 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 decreased substantially from $13.6 million in 2006 to $7.6 million in 2007, with much of the decrease occurring in the metro area.

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, Filed 2004 – 2007 (dollars in thousands)**

| | Filed 2004 | Filed 2005 | Filed 2006 | Filed 2007 |
|---|---|---|---|---|
| **Total Metro** | $2,463 | $2,636 | $10,224 | $4,940 |
| **Total Nonmetro** | $1,241 | $1,663 | $3,390 | $2,655 |
| **State** | $3,704 | $4,300 | $13,614 | $7,595 |

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 (DOR) 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, 2009, will be paid beginning in late September 2009. The deadline for filing claims based on taxes payable in 2009 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us. Also see the House Research Short Subject *Homeowner's Property Tax Refund Program*, December 2008, and the Information Brief *Targeting*, December 2007.

Randall Chun

Revised: December 2008

# Medical Assistance: An Overview

Medical Assistance (MA), the state's Medicaid program, is a jointly funded, federal-state program that pays for health care services for low-income individuals. The program is administered locally by counties, under the supervision of the state Department of Human Services (DHS). The program is governed by Minnesota Statutes, chapter 256B, and by federal Medicaid law, which allows states considerable flexibility in designing their Medicaid programs.

***Eligibility***

To be eligible for MA, an individual must meet the following criteria:

- Be a member of a group for which MA coverage is mandatory under federal law or a member of an optional group that the state has chosen to cover. Covered groups include families, children, pregnant women, the elderly, and persons with disabilities.

- Meet program income and asset limits. Different limits apply to different categories of individuals. Certain types of income and specified assets are excluded when determining eligibility. Income and asset limits for selected groups are described below.

| Eligibility group | Net income limit, as % of federal poverty guidelines (FPG) | Asset limit* |
|---|---|---|
| Children < age 2 | 280 | None |
| Children 2 through 18 | 150 | None |
| Children 19 through 20 | 100 | None |
| Pregnant women | 275 | None |
| Parents | 100 | $10,000 for one/$20,000 for two or more persons |
| Aged, blind, or disabled | 100 | $3,000 for one/$6,000 for two/$200 each additional |

* The homestead, household goods, a vehicle, a burial plot and certain assets for burial expenses, and other specified items are not counted as assets.

Individuals with incomes over these limits can also qualify for MA through a spenddown. Under a spenddown, an individual must incur medical bills in an amount that is equal to or greater than the amount by which the individual's income exceeds the spenddown limit of 100 percent of FPG for families and children and 75 percent of FPG for individuals who are aged, blind, or disabled.

*Eligibility (cont.)*

- Be a U.S. citizen or a noncitizen who meets specified immigration criteria.
- Be a resident of Minnesota.
- Meet other program eligibility requirements.

*Covered services*

Minnesota provides all federally mandated services and most services designated by the federal Medicaid program as optional. These services include, but are not limited to: physician care, hospitalization, therapy and rehabilitation, dental, medical equipment and supplies, home health care, health clinic services, mental health, prescription drugs, medical transportation, nursing home, and intermediate care facility for persons with mental retardation and related conditions (ICF/MR) services. Adult enrollees who are not pregnant are subject to copayments for certain services.

The state has also received federal approval to provide services not normally covered by Medicaid. These home and community-based "waivered services" are intended to make it possible for individuals to remain in the community, rather than reside in a hospital, nursing home, or ICF/MR.

*Provider reimbursement*

The MA program reimburses providers under both a fee-for-service system and a managed care system (composed of the Prepaid Medical Assistance Program or PMAP and county-based purchasing initiatives). Under the fee-for-service system, health care providers bill DHS and are reimbursed at rates specified by state law. Under managed care, prepaid health plans (or counties in the case of county-based purchasing) receive a monthly capitation payment for each enrollee. The state does not set provider reimbursement rates; these rates are instead the product of negotiation between the health care providers and the prepaid health plan or county.

*Funding and expenditures*

The federal share of MA costs is determined by a formula that is based on state per capita income. In fiscal year 2008, the federal government pays 50 percent of the cost of MA services, and the state is responsible for the remaining 50 percent. In fiscal year 2007, total state and federal MA expenditures for services were $5.817 billion.

*Recipients*

During fiscal year 2007, an average of 509,000 individuals were eligible for MA services each month. As of September 2008, 328,149 MA recipients received services under PMAP or a county-based purchasing initiative.

*Application procedure*

Individuals interested in applying for MA should contact their county human services agency.

**For more information:** See the House Research information brief *Medical Assistance*.

Joel Michael

Updated: December 2008

# Corporate Franchise Tax

***Corporate franchise tax applies to "C" corporations***

The corporate franchise tax, also frequently referred to as the corporate income tax, applies to "C" corporations (i.e., corporations and some partnerships) that are taxable under subchapter "C" of the Internal Revenue Code. Entities exempt from the tax include the following:

- "Pass-through entities" (e.g., partnerships, "S" corporations, and other entities that do not pay entity level taxes); the owners of these entities (shareholders or partners) only pay tax on their respective shares of the business entity's income. These entities are subject to the minimum fee (see below).
- Insurance companies (Insurers pay a premium tax instead)
- Credit unions

Charitable organizations and other entities are exempt from the federal income tax.

***Tax base is profits***

The tax base is essentially the profits of C corporations. State law defines the tax base by reference to the definition of taxable income under the federal corporate income tax. For example, federal depreciation rules are generally followed, except "bonus depreciation" and section 179 expensing are subject to special Minnesota rules. Minnesota deviates from the federal rules in some important ways. In particular, it provides an exemption for some types of foreign source income and for payments from foreign operating corporations. The Minnesota tax also taxes some income exempt under federal law, such as state and local bond interest.

***Tax rate is 9.8 percent***

A flat tax rate of 9.8 percent applies to Minnesota taxable income.

***Income is apportioned to Minnesota using a weighted three-factor formula of property, payroll, and sales***

Many corporations operate in more than one state. Under the United States Constitution, a state can legally tax only the income of a business that is "fairly apportioned" to the activity in the state. All states do this using formula apportionment (i.e., based on the in-state percentage of one or more factors).

Minnesota apportions a multistate corporation's income using a weighted three-factor formula of sales (81 percent weight), property (9.5 percent), and payroll (9.5 percent). (These weights are for tax year 2008. Minnesota is moving to apportionment solely based on the sales factor, effective for tax year 2014.) The Minnesota percentage for each factor is multiplied by the weight and the three factors added to determine the Minnesota percentage of the corporation's total income. For unitary businesses operating through several corporations (e.g., parent-subsidiary), all of their income is combined. This is referred to as the "combined reporting" method of apportionment. (For more information on apportionment, see the separate Short Subject, *Apportionment of Corporate Franchise Tax*.)

***Various tax credits apply***

The corporate franchise tax is reduced by various tax credits. These include credits for the following:

- Research and development
- Tax paid to another state
- Enterprise zone activity
- Jobs credit under the JOBZ program

***Revenues go to the general fund***

Fiscal year 2008 actual revenues were $1,020 million or about 6 percent of general fund revenues. Revenues from the corporate franchise tax are deposited in the general fund. The Department of Management and Budget estimated in February 2008 that corporate franchise tax collections will be $1,034 million in fiscal year 2009 and $1,085 million in fiscal year 2010.

***Revenues are elastic but very volatile***

Revenues under the tax are elastic; they grow as the size of the economy grows. But they are also the most volatile of the major taxes imposed by the state. When the economy slows down or goes into recession, corporate profits and the franchise tax tend to drop quite precipitously. For example, in fiscal year 2000 (an expansion year) the state collected $800 million in corporate franchise tax. In fiscal year 2002 (a year in which a mild recession occurred), corporate franchise tax revenues dropped to $533 million or 33.8 percent less than 2000.

***A minimum tax applies***

An alternative minimum tax or AMT applies under the franchise tax. This tax closely follows the similar federal AMT. A corporation must compute its tax under the AMT, using a broader tax base (e.g., less generous depreciation rules) and lower tax rate (5.8 percent). If the AMT results in a higher tax, the corporation must pay this amount.

***A minimum fee applies to most entities***

All corporations (both S and C corporations) and partnerships must pay a minimum fee based on the sum of their Minnesota property, payroll, and sales. This fee is an "add-on" fee that must be paid in addition to the tax computed under the regular tax or AMT. The schedule for the fee is shown to the right. The dollar amounts of the fee schedule have not been changed since the fee was enacted in 1990.

**Fee Schedule**

| Minnesota Property, Payroll, and Sales | Fee |
|---|---|
| Less than $500,000 | 0 |
| $500,000 - $999,999 | $100 |
| $1,000,000 - $4,999,999 | $300 |
| $5,000,000 - $9,999,999 | $1,000 |
| $10,000,000 - $19,999,999 | $2,000 |
| $20,000,000 or more | $5,000 |

**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*, June 2008, and *Apportionment of Corporate Franchise Tax*, October 2008.

HOUSE RESEARCH | Short Subjects

Pat Dalton and Steve Hinze

Updated: December 2008

# County Program Aid

***County program aid replaced several county aid programs***

Prior to calendar year 2004, counties received property tax aid under a number of different programs. Beginning in 2004, the aid programs were consolidated into one general aid program, called county program aid (CPA). The county aid programs that were consolidated include the following:

- attached machinery aid (Minn. Stat. § 273.138)
- homestead and agricultural credit aid (HACA) (Minn. Stat. § 273.1398, subd. 2)
- manufactured home homestead and agricultural credit aid (Minn. Stat. § 273.166)
- county criminal justice aid (CCJA) (Minn. Stat. § 477A.0121)
- family preservation aid (FPA) (Minn. Stat. § 477A.0122)

***County program aid consists of "need aid" and "tax-base equalization aid"***

From calendar year 2005 to calendar year 2008, CPA has been allocated by two formulas, need aid and tax-base equalization aid, with approximately $100 million being distributed through the need aid formula and $105 million being distributed through the tax base equalization aid formula. The table on the next page shows the calculation of a county's aid under each formula.

***The appropriation is increased in 2009***

The appropriation for CPA increases beginning in calendar year 2009 by $22 million, with $11 million going to each of the two parts. For aids payable in 2010 and 2011 the appropriation is scheduled to further increase by 2 percent per year. For aid paid in calendar year 2011 and thereafter, about $116 million will be distributed under the need aid portion and about $121 million under the tax base equalization aid portion of CPA.

***Counties receiving less aid under the post-2004 formula receive transition aid***

Seven counties whose relative *share* of the total CPA formula allocation in calendar year 2005 was significantly less than their share of 2004 program aid qualify for "transition aid." Each county's transition aid amount is permanently fixed at one-third of the amount it received in 2005. The total amount of transition aid for calendar year 2009 is $464,000.

***Additional aid granted to counties with special circumstances***

The 2008 tax bill granted supplemental payments of $500,000 to Beltrami County and $100,000 to Pine County for special circumstances in 2009 only.

## Calculation of County Program Aid

| Need Aid | Tax-base Equalization Aid |
|---|---|
| **Share of Appropriation:**<br>$100.5 million (CY 2005-2008)<br>$111.5 million (CY 2009)<br>$113.7 million (CY 2010)<br>$116 million (CY 2011 and thereafter) | **Share of Appropriation:**<br>$105 million (CY 2005-2008)<br>$116.1 million (CY 2009)<br>$118.5 million (CY 2010)<br>$120.8 million (CY 2011 and thereafter) |
| **Reductions from the appropriation:** $500,000 annually for court-ordered counsel and public defense costs | **Reduction from the appropriation:** up to $312,000 annually to pay for the preparation of local impact notes |
| **Factors used in the formula:**<br>• **age-adjusted population,** which ranges from 80% to 180% of the county's actual population based on the percentage of the county's population over 65 years, compared to the statewide average<br>• **average monthly number of households receiving food stamps** in the county over the last three years<br>• **average number of Part I crimes** reported in the county over the last three years. These are the most serious crimes | **Tax-base equalization factor used in the formula:**<br>**Factor = N** times ($185 x population - 9.45% of the county adjusted net tax capacity)<br>**where N equals:**<br>• 3 if the county population is less than 10,000;<br>• 2 if the county's population is at least 10,000 but less than 12,500;<br>• 1 if the county's population is at least 12,500 but less than 500,000; and<br>• 0.25 if the county's population is 500,000 or more |
| **The formula:**<br>• 40% of the appropriation is distributed to each county based on its relative share of the total age adjusted population in the state<br>• 40% of the appropriation is distributed to each county based on its relative share of the total average monthly number of households receiving food stamps in the state<br>• 20% of the appropriation is distributed to each county based on its relative share of the average number of Part I crimes reported in the state | **The formula:**<br>• 100% of the appropriation is distributed based on each county's relative share of the sum of the tax-base equalization factors for all the counties in the state |

**For more information:** Contact legislative analyst Steve Hinze at 651-296-8956 or Pat Dalton at 651-296-7434. Also see the House Research publication *Aid Cuts to Local Governments in CY 2003 and 2004*, February 2004.

# HOUSE RESEARCH | Short Subjects

Jim Cleary and Rebecca Pirius

Updated: December 2008

# 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 after cancellation for a third or subsequent impaired driving incident. To be eligible, the offender must complete chemical dependency treatment and a rehabilitation period described in law. 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, if the person was driving, criminal penalties. Thus with the B-Card, the repeat-DWI offender gets another chance to legally drive, but only if he or she remains permanently chemically free.

***When is a person's driver's license cancelled?***

The Department of Public Safety (DPS) may cancel a person's driver's license when it deems that the person's operation of a motor vehicle is inimical to public safety. Pursuant to this authority, DPS cancels a person's license when he or she has three impaired driving incidents within ten years or four incidents on record.

***What counts as an impaired driving incident?***

An alcohol- or controlled substance-related driving violation that results in either an administrative loss of driver's license, a criminal conviction for a DWI, or criminal vehicular homicide constitutes an impaired driving incident. Even if a DWI criminal charge is dropped or reduced to a lesser charge, the implied consent revocation alone counts as a qualified prior impaired driving incident.

***What is a restricted driver's license?***

Minnesota Statutes, section 171.09, authorizes the 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, he or she must absolutely abstain from alcohol and illicit drugs permanently. This restricted 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 impaired driving incident), 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 the abstinence 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. It 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, this 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 cancelled 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 *Ascher v. the Commissioner of Public Safety* (1994), the Minnesota Court of Appeals 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 for obtaining a B-Card 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.

***What criminal penalties apply?***

In addition to the administrative sanctions, the law also provides for gross misdemeanor criminal penalties upon conviction for a violation of the no-alcohol/drug restriction of the B-Card license while driving (Minn. Stat. § 171.09(d)(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:** See the House Research publication *An Overview of Minnesota's DWI Laws*, November 2008.

Randall Chun

Revised: December 2008

# MinnesotaCare: An Overview

MinnesotaCare is a state program that provides subsidized health care coverage to low- and moderate-income families and individuals. The program is administered by the Department of Human Services (DHS); counties have the option of processing applications and determining eligibility. The program is governed by Minnesota Statutes, chapter 256L.

***Eligibility***

To be eligible for MinnesotaCare, an individual must meet the following criteria:

- Have gross income that does not exceed 275 percent of the federal poverty guidelines (FPG) for families and children ($58,308 for a household of four), and 200 percent of FPG for adults without children ($20,808 for a household of one and $28,008 for a household of two). Parents with annual gross incomes over $50,000 are ineligible, whether or not they otherwise meet the 275 percent of FPG standard; this income cap does not apply to pregnant women and minor parents.
- Have assets that do not exceed $10,000 for a household of one and $20,000 for a household of two or more, after certain exclusions. This asset standard does not apply to pregnant women and children.
- Not have access to employer-subsidized health care coverage, and not have had access to this coverage through the current employer for 18 months prior to application or renewal. This requirement does not apply to children with incomes that do not exceed 150 percent of FPG and certain other children.
- Have no health care coverage at the time of application and for four months prior to application or renewal. Children with incomes that do not exceed 150 percent of FPG and certain other children considered to be "underinsured" are exempt from this requirement.
- Be a resident of Minnesota. Pregnant women, families, and children must meet the residency requirements of the Medical Assistance (MA) program; adults without children must satisfy a 180-day residency requirement.
- Since September 1, 2006, certain General Assistance Medical Care applicants and recipients have been enrolled in MinnesotaCare as adults without children and are exempt from premiums and certain eligibility criteria until six-month renewal.

***Covered services***

Pregnant women and children have access to a broader range of covered services than adults who are not pregnant. Pregnant women and children receive coverage for all health care services provided under MA. MA covers physician care, hospitalization, prescription drugs, nursing home care, and a wide range of other health care and long-term care services.

Parents, and adults without children, are covered for most, but not all MA services. Parents with household incomes greater than 175 percent of FPG and all adults without children are subject to an annual inpatient hospital benefit limit of $10,000. The income limit above which parents are subject to this annual limit will increase to 200 percent of FPG, effective April 1, 2009. Services not covered include personal care attendant services, private duty nursing, nursing home care, ICF/MR (intermediate care facility for persons with mental retardation and related conditions), and special transportation services.

***Premiums and cost-sharing***

Enrollees must pay premiums based on a sliding scale. Children with incomes that do not exceed 150 percent of FPG pay a reduced annual premium of $48. Adult enrollees who are not pregnant are subject to coinsurance and copayments for specified services.

***Provider reimbursement***

All enrollees receive health care services through prepaid health plans. The MinnesotaCare program pays prepaid health plans a monthly capitation payment for each MinnesotaCare enrollee. MinnesotaCare does not set provider reimbursement rates; these rates are instead the result of negotiation between health care providers and the prepaid health plan.

***Funding and expenditures***

In fiscal year 2007, the MinnesotaCare program paid $434 million for medical services provided to enrollees. Sixty-one percent of this cost was paid for by the state, 31 percent by the federal government, and 8 percent by enrollees through premium payments (this last category also includes copayments and prescription drug rebates).

State funding for MinnesotaCare and other health care access initiatives is provided by a tax of 2.0 percent on the gross revenues of health care providers and a tax of 1.0 percent on the premiums of nonprofit health plan companies.

The state receives federal funding at the MA match rate for health care services provided to enrollees who are children, parents, or pregnant women. The state receives federal funding at an enhanced match rate (under the State Children's Health Insurance Program) for parents and relative caretakers with incomes between 100 percent and 200 percent of FPG, through January 31, 2009. Beginning February 1, 2009, this group of parents will receive the regular MA match, and the enhanced federal match will be applied to MinnesotaCare children age 18 or younger with incomes greater than 150 percent of FPG.

***Recipients***

As of April 2008, 114,566 individuals were enrolled in the MinnesotaCare program. Just over 60 percent of these enrollees were parents, children, or pregnant women.

***Application procedure***

MinnesotaCare applications can be obtained by calling 1-800-657-3672. Applications are also available at county human services agencies.

**For more information:** See the House Research information brief *MinnesotaCare*, December 2008.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2008

# Minnesota's Individual Income Tax

*How much are income tax revenues?*

Minnesota's income tax revenues are projected to equal $7.4 billion in fiscal year 2008, about 44 percent of state tax collections and 38 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. In calculating MTI, taxpayers are required to add certain types of income to FTI and allowed to subtract other kinds of income. Some of the subtractions are required under federal law. For more detail on these adjustments, see the House Research publication *Minnesota Taxable Income,* August 2008.

Minnesota has not conformed to federal changes to the definition of FTI enacted since the end of the 2008 legislative session, some of which affect tax year 2008. Unless legislation conforming to the recent federal changes to FTI is enacted early in the 2009 session, taxpayers will have to use form M1NC to undo the federal changes before calculating their Minnesota tax. Some taxpayers will have to recompute federal phaseouts of items such as personal and dependent exemptions and medical expenses. Others will simply have to add back deductions allowed at the federal but not the state level, including:

- higher education tuition and fees deduction,
- teacher classroom expenses deduction, and
- exclusion for IRA distributions made to charities.

*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 2009 (brackets for married taxpayers, filing separately, are half the width of the married joint brackets):

| | Married Joint | Single | Head of Household |
|---|---|---|---|
| **5.35%** | First $32,860 | First $22,480 | First $27,670 |
| **7.05%** | $32,861 to $130,540 | $22,481 to $73,830 | $27,671 to $111,190 |
| **7.85%** | All over $130,540 | All over $73,830 | All over $111,190 |

A married couple filing a joint return owes income tax equal to 5.35 percent of their first $32,860 of taxable income, 7.05 percent of income between $32,860 and

$130,540, and 7.85 percent of taxable income over $130,540. 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:

- Credit for taxes paid to other states ($125.7 million in tax year 2006)
- Marriage credit ($64.6 million in fiscal year 2010)
- Credit for past military service ($10.3 million in fiscal year 2010)
- Long-term care insurance credit ($7.5 million in fiscal year 2010)

In addition, Minnesota allows eight refundable credits, which are paid as refunds to taxpayers even if the credit amount is greater than their income tax liability:

- Working family (earned income) credit ($163.4 million in fiscal year 2010)
- Motor fuels tax credit ($29.8 million in fiscal year 2010)
- Dependent care credit ($13.9 million in fiscal year 2010)
- K-12 education credit ($13.1 million in fiscal year 2010)
- Military combat zone credit ($2.2 million in fiscal year 2010)
- Job opportunity building zone (JOBZ) credit ($1 million in fiscal year 2010)
- Bovine tuberculosis testing credit ($0.34 million in fiscal year 2010)
- Enterprise zone credit ($0.1 million in fiscal year 2010)

Credit amounts are from the Minnesota Department of Revenue's *Tax Expenditure Budget, Fiscal Years 2008-2011,* Department of Revenue estimates, and income tax return processing data.

**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, *Minnesota Taxable Income*, August 2008; *The Minnesota Income Tax Marriage Credit*, December 2008; *The Minnesota and Federal Dependent Care Tax Credits*, December 2008; *The Federal Earned Income Credit and the Minnesota Working Family Credit,* December 2007; *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, November 2008; and *Income Tax Terms: Deductions and Credits*, July 2007.

Anita Neumann

Updated: October 2008

# Unemployment Benefit Extensions and Supplemental Benefits in Minnesota

Current law limits most applicants to 26 weeks of unemployment benefits. Both the state and federal government, however, have provided additional benefits under special circumstances. The following information highlights those additional unemployment-related benefits.

***General extension provisions available under state and federal law***

Both state and federal law contain provisions that allow for additional unemployment benefits to be paid under special conditions. The federal program provides 13 weeks of extended benefits when the unemployment rate in a state meets a specific level that the state has the authority to set for itself.

Extended benefits become available in Minnesota under the following conditions:

1. If in any week and the preceding 12 weeks, the rate of insured unemployment: (a) is 6 percent or more; or (b) is 5 percent or more and at least 120 percent of the average of the rates in the corresponding 13-week period in each of the two prior calendar years; or
2. The U.S. Secretary of Labor determines that the state's average rate of seasonally adjusted unemployment (in the most current three-month period for which data is available) is 6.5 percent or more and at least 110 percent of the rate in the corresponding three-month period in either of the prior two calendar years.

***Additional state benefits***

In addition to the general provisions available under state and federal law, additional unemployment benefits are available in Minnesota if:

- at a facility with at least 100 employees, the employer lays off at least 50 percent of the workforce in a one-month period;
- the employer has no plan to resume operations leading to the reemployment of the laid-off workers in the immediate future; and
- the seasonally adjusted unemployment rate in the county where the facility is located was at least 10 percent during the month of the layoffs or during the three months before or after the month in which the reductions were made.

The legislature has also provided special benefit provisions for particular workers.

- In 1998, the legislature suspended the unemployment rate and mass layoff requirements to make 13 weeks of additional benefits available to employees laid off from Hibbing Taconite.
- In 2000, the legislature suspended the same requirements to offer 13 weeks of extra benefits to employees from Eveleth Taconite and 26

weeks of extra benefits available to employees from Hennepin Paper. The Hennepin Paper employees were required to be in training in order to receive benefits.

- In 2001, the legislature provided an additional 26 weeks of benefits to employees from LTV Steel, again requiring that applicants be in training.
- In 2002, the legislature provided additional benefits to several categories of workers. Employees laid off during specified periods from Farmland Foods, from Fingerhut in St. Cloud, Mora, or Eveleth, or from a list of named airlines were provided with an additional 13 weeks of benefits. Again, these individuals were required to be in training in order to continue collecting benefits.
- In 2007, the legislature enacted up to 13 weeks of extra benefits for workers laid off after April 1, 2006, from the Ainsworth Lumber Company plants in Bemidji, Cook, and Grand Rapids. This provision included the training requirement.
- In 2008, extra benefits were extended until December 27, 2008, to employees of the Ainsworth Lumber Company plant in Cook, who exhausted their regular unemployment benefit entitlement after January 1, 2008. A training requirement was not required for these benefits.

*Additional federal benefits*

**Emergency Unemployment Compensation (EUC).** In 2008, Congress passed a federal Emergency Unemployment Compensation (EUC) program that provides up to 13 weeks of federally funded additional benefits for individuals who exhaust their regular benefits and remain unemployed. This program is available for anyone who exhausted benefits after April 30, 2007, and was still seeking employment as of July 6, 2008. The week of June 6, 2008, is the first week that benefits were available. The last week benefits will be paid is the week ending July 4, 2009.

**Federal Trade Readjustment Allowances.** Under federal law, Trade Readjustment Allowances provide income support to persons who have exhausted their unemployment benefit entitlement and who were laid off or had hours reduced by their employer as a result of increased imports from other countries. Benefits under this program include job training, job search, and relocation assistance.

**Federal Disaster Unemployment Assistance.** The U.S. Department of Labor's Disaster Unemployment Assistance provides financial help to workers whose employment was interrupted or eliminated as a result of a disaster declared by the president. To be eligible for these benefits, a worker cannot be eligible for regular unemployment benefits.

Disaster employment assistance is available beginning with the first week following the beginning of the disaster and ends 26 weeks after the president's disaster declaration.

**For more information:** Contact legislative analyst Anita Neumann at Anita.Neumann@house.mn.