Short Subjects

Minnesota House of Representatives, House Research

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HOUSE RESEARCH | **Short Subjects**

Deborah Dyson and Mark Shepard **Updated: January 2011***

Compensation Limits for Local Government Employees

What is the compensation limit for local government employees?

State law limits the compensation for an employee of a political subdivision to 110 percent of the governor's salary, with annual adjustments based on the Consumer Price Index (CPI). The current salary of the governor is $120,303. The compensation for an employee of a political subdivision cannot exceed 110 percent of that amount, which is $132,333, adjusted annually to reflect any increase in the CPI for all-urban consumers in the prior year. Minn. Stat. § 43A.17, subd. 9. As of January 1, 2011, the limit is $151,866. (For more information see the Minnesota Management and Budget website at http://www.mmb.state.mn.us/comp-salarycap-waiver.).

This compensation limit applies to employees of statutory and home rule charter cities, counties, towns, metropolitan and regional agencies, and other political subdivisions. The compensation limit does not apply to school districts, to hospitals, clinics, or health maintenance organizations owned by a governmental unit, or to medical doctors and doctors of osteopathy.

What is included in "compensation"?

The statute specifies what is considered compensation for purposes of the limit. The statutory limit compares the *compensation* of political subdivision employees to the *salary* of the governor. For political subdivision employees, compensation includes certain benefits as well as salary. The statute determines what is included and excluded for purposes of the compensation limit.

Included

- All deferred compensation
- All direct and indirect items of compensation that are not specifically excluded by the statute (e.g., cash allowance for personal use of a car is included)

Excluded

- Benefits that are provided for the majority of all other full-time employees of the political subdivision, vacation and sick leave, health and dental insurance, disability insurance, term life insurance, and pension benefits
- Dues paid to civic, professional, educational, or governmental organizations
- Reimbursement for actual expenses that are directly related to the job

The statute contains a process and criteria for granting exemptions

The Commissioner of Minnesota Management and Budget (MMB) may increase the compensation limit for a position that the commissioner determines requires special expertise necessitating a higher salary to attract or retain a qualified person. In making this determination, the commissioner must consider salary rates paid to other people with similar responsibilities in the state and nation. Before granting an exception to the salary limit, the commissioner also must seek the advice of the Legislative Coordinating Commission.

Any increase must also be adjusted annually by any increase in the CPI from the prior year. Minn. Stat. § 43A.17, subds. 3 and 9. According to MMB, as of January 1, 2011, a local government may increase by 1.2 percent the compensation of an employee with an existing waiver for compensation to exceed $132,333. If the existing approved waiver amount is below $151,866, the local government may increase an employee's compensation to the $151,866 limit without a waiver.

The legislature has been addressing the issue of political subdivision salary caps since 1977

In 1977, the legislature provided that no political subdivision employee could be paid more than the Commissioner of Finance. The 1980 Legislature repealed the political subdivision salary cap. In 1983, the legislature enacted something similar to the current cap—compensation for local government employees was limited to 95 percent of the governor's salary. There have been various refinements to the law since 1983. Most significantly, in 1993 the legislature clarified what types of compensation are to be included when comparing a political subdivision employee's compensation to the governor's salary. In 2005, the legislature debated repealing the cap altogether but decided to increase the cap and allow for annual adjustments due to inflation.

There is a separate limit for state employees

The statute limiting political subdivision salaries does not cover state employees, but there is a separate limit for state employees. With very limited exceptions, no state employee may earn more than the head of the agency where the employee works. Minn. Stat. § 43A.17, subd. 1. State law assigns executive branch agency heads to two salary ranges, which are capped at 95 percent and 85 percent of the governor's salary. Minn. Stat. § 15A.0815, subds. 2 and 3. (These comparisons are based strictly on salary, not on total compensation.) The heads of the higher education systems are treated separately and are not limited by the governor's salary.

For more information: Contact legislative analysts Deborah Dyson at 651-296-8291 or Mark Shepard at 651-296-5051. Also see the House Research publication *State Agency Head Salaries*, October 2008.

* Previous versions of this short subject have been in the form of information briefs.

Steve Hinze and Karen Baker Updated: January 2011

Property Tax 101: Basic Terms and Concepts

Estimated market value	The assessor determines each property's **estimated market value** based on sales of comparable properties, cost of construction minus depreciation, income generated by the property (if applicable), and other relevant available information.
Taxable market value	**Estimated market value** and **taxable market value** are the same for most types of property. However, certain programs, such as the Green Acres program and the This Old House program, provide for reduced valuations for enrolled properties, making the property's **taxable market value** less than its estimated market value.
Net tax capacity, class rate	A property's **net tax capacity** is determined by multiplying the property's taxable market value by the relevant **class rate** or rates. Class rates are set by statute, vary by property type, and are uniform statewide.
Levy, levy limit	Each local taxing jurisdiction certifies a **levy** equal to the amount of revenue it desires to raise through the property tax in the upcoming year. For many local taxing jurisdictions, the levy may be constrained by state-imposed **levy limits.**
Local tax rate	The **local tax rate** of a taxing jurisdiction is determined by dividing the jurisdiction's **levy** by the total **net tax capacity** of all properties within the jurisdiction.
Total local tax rate	The **total local tax rate** for an individual property is the sum of the local tax rates of all taxing jurisdictions allowed to levy taxes upon the property.
Market value-based levy and tax rate	Certain voter-approved levies must be levied against market value rather than net tax capacity. The **market value-based tax rate** is determined by dividing the jurisdiction's **market value-based levy** by the total **taxable market value** of all properties within the jurisdiction (excluding the value of property classified as agricultural or seasonal-recreational, since those property types are exempt from market value-based taxes).
Gross tax, property tax credits, net tax	**Property tax credits** reduce the **gross tax** that would otherwise be due upon a property. The remaining amount after subtraction of property tax credits is the **net tax**. The **market value homestead credit** and the **market value agricultural credit** are the two most common property tax credits and are based on formulas related to the market value of the property. Other property tax credits include the taconite homestead credit, the disparity reduction credit, and the power line credit.
Property tax computation	On the back is an example illustrating how the property tax is computed for a hypothetical residential homestead.

Computation of Property Tax for a Hypothetical Property

1. Determine the property's ***taxable market value***	$200,000
2. Determine the ***class rate*** based on property type	Residential homestead: 1.0%
3. Multiply taxable market value by class rate to obtain the ***net tax capacity***	$200,000 X 1.0% = $2,000
4. Determine the ***total local tax rate*** by summing the tax rates of all jurisdictions authorized to levy property taxes upon the property (i.e., jurisdictions whose boundaries include the property)	County 40% City/town 30 School district 20 Special districts 5 Total 95%
5. Multiply net tax capacity by total tax rate to determine the net tax capacity-based portion of the ***gross tax***	$2,000 X 95% = $1,900
6. Determine the total ***market value tax rate*** by summing the market value tax rate for all taxing jurisdictions authorized to levy property taxes upon the property	County 0.00% City/town 0.00 School district 0.15 Special districts 0.00 Total 0.15%
7. Multiply taxable market value by total market value tax rate to determine the market value-based portion of the ***gross tax***	$200,000 X 0.15% = $300
8. Add the net tax capacity-based gross tax to market value-based gross tax to obtain the total ***gross tax***	$1,900 + $300 = $2,200
9. Determine the ***homestead credit*** amount for home of this value	$192
10. Subtract the homestead credit from the gross tax to obtain the ***net tax***	$2,200 - $192 = $2,008

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

Steve Hinze and Karen Baker

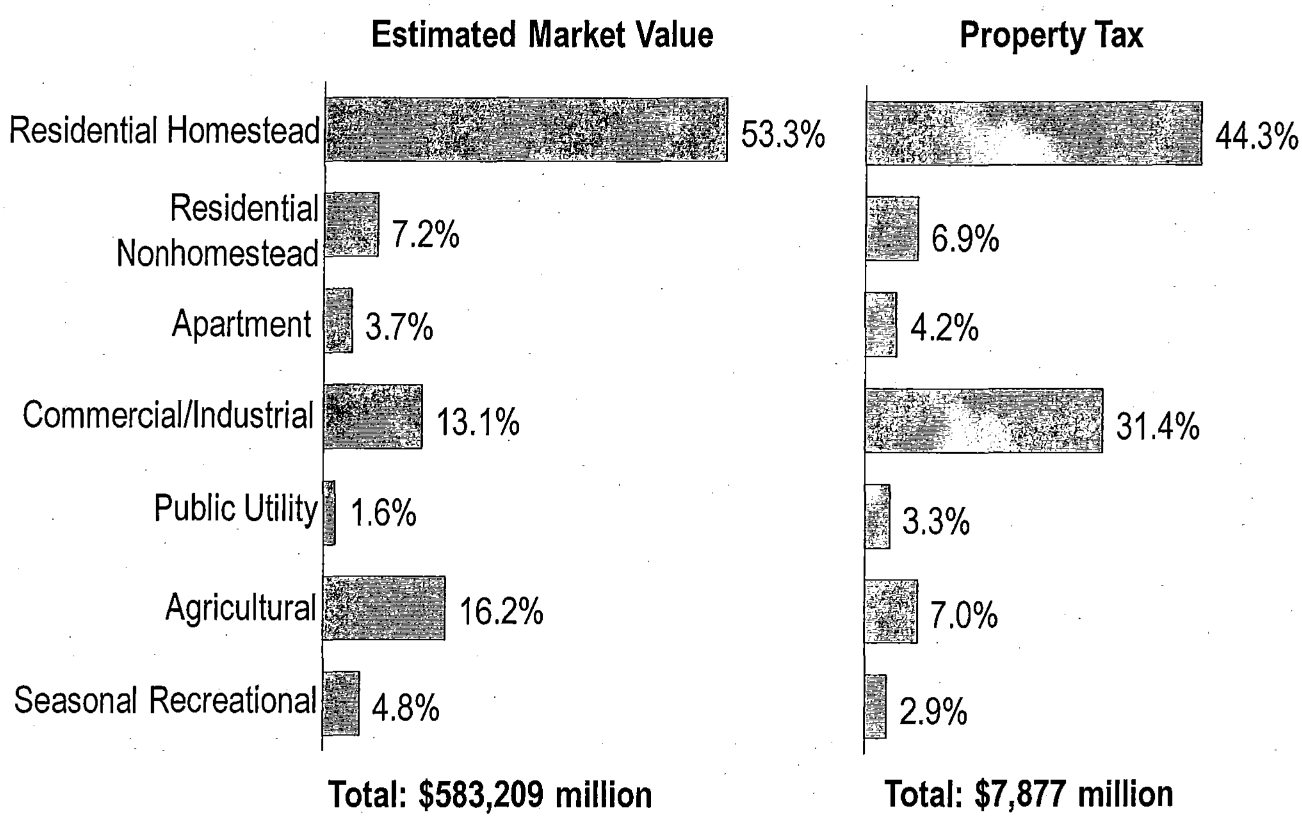
Updated: January 2011

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

Where property taxes come from

Total property taxes statewide were $7,877 million for calendar year 2010. The total amount of property value (excluding the value of exempt property) was $583,209 million. The graphs below show the breakdown of the state's total property tax base by market value and by taxes paid in 2010.

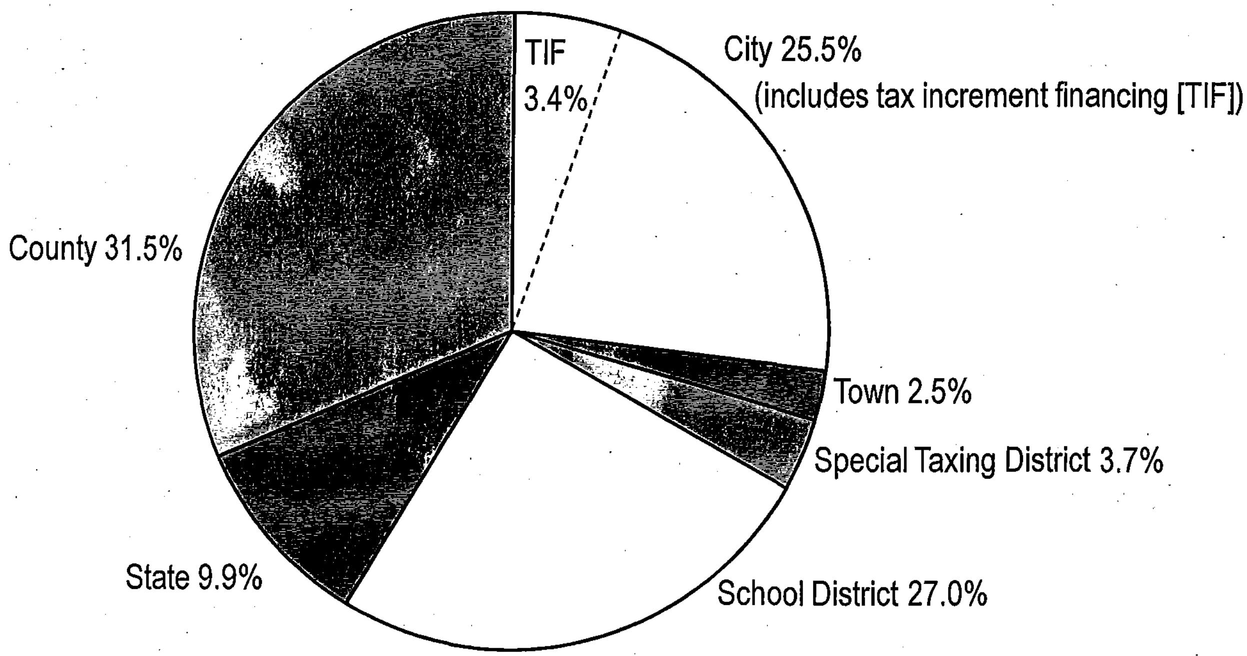
Statewide Shares of Market Value and Property Tax by Property Type (Taxes Payable 2010)



Where property taxes go

The total property tax burden in Minnesota was $7,877 million for calendar year 2010. 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 2010
(Total: $7,877 million)



*Amounts shown are after allocation of property tax credits.

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

HOUSE RESEARCH | Short Subjects

Nina Manzi and Janelle Taylor

January 2011

Minnesota's Nongame Wildlife Checkoff

What is the nongame wildlife checkoff?

Minnesota's nongame wildlife checkoff allows individuals to make contributions on their individual income tax or property tax refund return to the states' nongame wildlife fund. Corporate taxpayers may also contribute on their corporate franchise tax return. Taxpayers who wish to contribute fill in the amount of their contribution on their income tax or property tax refund form. The amount of the contribution is then either added to their tax due or subtracted from their refund.

How much do taxpayers contribute to the nongame wildlife checkoff?

In 2009, 69,143 individuals used the nongame wildlife checkoff to contribute just over $1 million to the nongame wildlife fund on their individual income tax or property tax refund forms. The average contribution was just under $16. About 2.1 percent of all filers made contributions—2.3 percent of income tax filers and 1.3 percent of property tax refund filers. Since 1998, taxpayers have contributed about $1 million per year through the checkoff, but the share of filers making contributions has decreased.

Nongame Wildlife Checkoff Contributions, 1998 to 2009

Year	% contributing	$ contributed	Average contribution
1998	2.9%	$972,996	$11.41
1999	2.0	1,003,721	12.01
2000	2.9	1,028,790	12.16
2001	3.0	1,134,319	13.23
2002	3.0	1,160,518	13.07
2003	3.0	1,154,574	13.11
2004	2.8	1,171,942	13.75
2005	2.6	1,098,310	14.12
2006	2.1	1,030,219	15.31
2007	2.1	1,075,785	15.34
2008	2.1	1,093,113	15.46
2009	2.1	1,086,545	15.72
Source: Minnesota Department of Revenue			

What are contributions to the checkoff used for?

Contributions to the nongame wildlife checkoff go into the nongame wildlife fund and are appropriated to the Department of Natural Resources for its nongame wildlife program. Although donations from the nongame wildlife checkoff provide the majority of the funding for the nongame wildlife program, the program also receives funding from the general fund, the game and fish fund, and other sources.

The nongame wildlife program focuses on nongame wildlife species that have been identified as being rare, declining, or vulnerable in the state; these species are known as "species of greatest conservation need." The program supports six regional wildlife specialists who work toward three major goals designed to protect these species:

- Stabilizing and increasing the populations of the species
- Improving knowledge of the species
- Enhancing people's appreciation and enjoyment of the species

What are some recent projects funded through the nongame wildlife checkoff?

The nongame wildlife program has supported a number of projects in recent years, including the Project WILD program, which is an environmental and conservation education program designed to train K-12 and other youth and environmental educators on how to develop awareness of and foster responsible actions towards wildlife and related natural resources. Other projects have included surveys of various species including loons, bald eagles, frogs, and dragonflies, and the acquisition of lands for various wildlife management areas and aquatic management areas across the state to provide habitat for many wildlife species.

How many other states have a nongame wildlife checkoff?

Thirty-six of the 42 states (and the District of Columbia) that have an individual income tax also have a nongame wildlife checkoff. Most states have more than one checkoff; Oregon has the most, with 25. Only three states offer only the nongame wildlife checkoff—Indiana, Minnesota, and North Carolina.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Janelle Taylor at 651-296-5039.

HOUSE RESEARCH | Short Subjects

Matt Burress **Updated: January 2011**

Motor Vehicle Sales Tax

The motor vehicle sales tax (MVST) has become an important funding source for transportation, although it had not historically been allocated solely to transportation. A constitutional amendment passed in 2006 will result in 100 percent of MVST revenues going to transportation purposes starting in fiscal year 2012.

MVST imposition and collection

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 vehicle. Some older autos as well as collector's vehicles have a flat tax instead. MVST is collected by auto dealers at the time of sale or when the vehicle is registered (for private party sales).

Periodic MVST dedication to transportation

The legislature first directed a portion of MVST revenue to highways and transit in 1981, with the intent that it supplement other transportation funding sources. Over the ensuing years, the percentage allocated to transportation was periodically changed and suspended; it was eliminated beginning in fiscal year 1992.

2000-2001 tax policy changes affecting MVST

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

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

2003 re-allocation to transit

In the 2003 session, the legislature increased the percentage of MVST revenue going to transit, but it was done without increasing the overall MVST allocation to transportation. The additional funding for transit was partially to make up for reductions in general fund appropriations for bus service throughout Minnesota (which was largely due to overall budget cuts), and partly to reduce local responsibility for Hiawatha light rail transit operating costs.

In effect, increased transit funding came from a reduction in the amount of MVST revenue going to the state trunk highway system. MVST revenue allocated to the highway user tax distribution (HUTD) fund was decreased with a corresponding increase in allocations to the metro area and greater Minnesota transit funds. Funds in the HUTD fund are constitutionally dedicated to state, county, and municipal highways and streets. The county state-aid highway fund and the municipal state-aid street fund received direct allocations from MVST revenue in order to offset the reduction in their portions of the HUTD funding (holding those funds "harmless").

The MVST constitutional amendment

At the 2006 general election, the voters approved a constitutional amendment dedicating all MVST revenue to transportation purposes. The amendment includes a phase-in period: 63.75 percent of the revenue must be dedicated to transportation purposes in fiscal year 2008, with the transportation share growing by 10 percentage points per year until reaching 100 percent starting in fiscal year 2012.

The constitutional language also requires that "no more than 60 percent" of the revenue go to the HUTD fund and "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13. These distribution limits establish a ceiling for allocation to highways and a floor for allocation to transit. Within the distribution limits, the Constitution allows legislation to set the actual division between highways and transit.

MVST phase-in and allocation

Legislation passed in 2007 allocated MVST revenue under the phase-in. It was modified in 2009 by shifting additional funds from highways to transit for fiscal years 2010 and 2011, which was designed to help address transit deficits. 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 consisting of 36 percent for the metropolitan area and 4 percent for greater Minnesota).

MVST Phase-In Allocation

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012+
HUTD fund	30.00%	38.25%	44.25%	47.5%	54.5%	60.00%
County state-aid highway fund	0.65					
Municipal state-aid highway fund	0.17					
Metropolitan transit	21.50	24.00	27.75	31.5	35.25	36.00
Greater Minnesota transit	1.43	1.50	1.75	4.75	4.00	4.00
General fund	46.25	36.25	26.25	16.25	6.25	0.00

Note: Percentage allocations for transit in fiscal years 2010-11 include dollar caps not discussed here.

Additional MVST revenue

Additional revenue for transportation (with a corresponding reduction in revenue for the general fund) is estimated at about $252 million in fiscal year 2012, the first year in which the MVST dedication is fully phased in. This represents a drop from a 2006 estimate of $285 million, which is due to decreased MVST collections.

Additional Revenue from MVST Phase-In
(amounts in millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
HUTD fund	$32.0	$54.2	$71.8	$108.1	$152.3	$162.8
Metropolitan transit	17.9	32.1	49.1	70.2	84.3	90.1
Greater Minnesota transit	1.3	2.2	15.2	13.2	15.0	16.0
General fund	(51.3)	(88.5)	(136.1)	(191.5)	(251.6)	(269.0)

Note: Amounts are actual for fiscal years 2008-10 and estimated for subsequent fiscal years based on the Nov. 2010 forecast.

For more information: Contact legislative analyst Matt Burress at 651-296-5045. See also the House Research publication *Motor Vehicle Sales Tax Chronology*, August 2009.

HOUSE RESEARCH | Short Subjects

Lisa Larson

Updated: January 2011

Conditions of Continuing Employment for K-12 Teachers

"Continuing contract rights" and "tenure rights" offer equivalent procedural protections

Two sections of Minnesota Statutes govern conditions of continuing employment for licensed K-12 teachers in Minnesota's public schools. Section 122A.40 contains general provisions for all teachers' continuing contract rights except those teachers teaching in the three first-class city school districts of Minneapolis, St. Paul, and Duluth. Section 122A.41, which contains similar provisions, governs the tenure rights of teachers teaching in the three first-class city school districts. The terms "continuing contract rights" and "tenure rights" mean that a school district may not dismiss a teacher from a teaching position without first demonstrating the cause for that dismissal. The two terms are equivalent in the procedural protections they afford and are used interchangeably by educators, the courts, and others.

A newly licensed probationary teacher must successfully complete three consecutive years of continuous employment

Under state law, after a newly licensed probationary teacher successfully completes three years of continuous employment, she or he becomes a continuing contract teacher if employed by a nonfirst-class city school district, or a tenured teacher if employed by a first-class city school district. During the probationary period, a school district has considerable discretion in deciding whether or not to renew the probationary teacher's employment contract. A school district under section 122A.40 must notify a probationary teacher before July 1 that it will not renew the teacher's contract. Once a teacher receives a continuing contract or tenure, the teacher becomes entitled to a number of employment-related protections, including bumping rights and just cause and due process guarantees.

Teachers' continuing contracts remain in effect unless a specified circumstance arises

The continuing contracts of teachers in nonfirst-class city school districts under section 122A.40 remain in full force and effect unless:

- the school board and the teacher modify the contract;
- the school board terminates the teacher for inefficiency before April 1, neglect of duty, conduct unbecoming a teacher, or other grounds making the teacher unfit;
- the school board places the teacher on an unrequested leave of absence before July 1;
- the school board temporarily suspends the teacher and places the teacher on a leave of absence for health reasons;
- the school board immediately discharges the teacher for immoral conduct, conduct unbecoming a teacher, failure to teach, gross inefficiency, willful neglect of duty, or continuing physical or mental disability; or
- the teacher resigns before April 1 or, if a collective bargaining agreement is not settled, the teacher resigns within 30 days of when an agreement is ratified or July 15, whichever is first.

Tenured teachers cannot be discharged or demoted except for cause

Tenured teachers in first-class city school districts under section 122A.41 may be discharged or demoted for:

- immoral character, conduct unbecoming a teacher, or insubordination;
- failure to teach;
- inefficiency in teaching or in management of a school;
- affliction with a communicable disease; and
- discontinuance of position or lack of pupils.

School boards must follow procedures when terminating, discharging, or demoting a teacher

A teacher facing termination or immediate discharge in a nonfirst-class city school district can request a public or private hearing before the school board or an arbitrator. The board and the teacher may have counsel, who can examine witnesses and present arguments. A school board must base a decision to dismiss a teacher upon substantial and competent evidence in the hearing record. The teacher may appeal a board decision to the state courts.

The Minneapolis, St. Paul, and Duluth school boards can discharge or demote a teacher only after a full public or private hearing before the board or an arbitrator, at the teacher's election. The board may suspend a teacher against whom it has filed charges. The board and the teacher may have counsel, who can examine witnesses and present arguments, and both parties have the right to a written record. A vote by a majority of school board members is needed to discharge or demote a teacher. The teacher may appeal a board decision to the state courts.

An arbitrator who conducts a hearing must decide, based upon a preponderance of the evidence, whether to terminate, discharge, or demote the teacher. The arbitrator's decision is final and binding on the parties, and may not be appealed except on technical grounds.

Teachers may be placed on an unrequested leave of absence according to a negotiated or statutory plan

A school board may place a teacher on an unrequested leave of absence, without pay or fringe benefits, when the board discontinues the teacher's position, lacks sufficient students, faces financial limitations, or merges classes as a result of consolidating districts. If the school board and the teachers' exclusive bargaining representative fail to negotiate an unrequested leave of absence plan, then statutory terms control. A board must hold a public hearing on unrequested leaves before July 1. A majority roll call vote of the full board is needed to place teachers on leave.

Teachers are placed on leave based on the inverse order of their employment and on their areas of certification. Teachers' seniority applies to each area in which the teacher is certified. Teachers must be recalled to their positions, or other available positions, in the inverse order in which they were placed on leave; most senior teachers are recalled first. This seniority-based system rewards teachers with the longest service by giving them maximum employment security. Statutory terms governing resignations, leaves, certification, seniority and part-time experience, teachers' bumping rights, and districts' ability to realign positions also affect staff reduction decisions.

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

Lisa Larson

July 2011

School District Collective Bargaining

PELRA requires public employers and employees to negotiate terms and conditions of employment

The Public Employment Labor Relations Act (PELRA) establishes state collective bargaining laws that govern Minnesota public employers and representatives of unionized public employees (Minn. Stat. §§ 179A.01-179A.25). Under PELRA, public employers and representatives of public employees must negotiate terms and conditions of employment. Negotiated terms and conditions include hours of employment, fringe benefits, and personnel policies affecting employee working conditions. While most retirement benefits are not negotiable, school districts may negotiate contributions to premiums for group insurance coverage of retired employees and severance pay provisions. School district education policies are not part of these teacher negotiations. Public employers need not negotiate inherent managerial policies, such as budget matters, technology use, organizational structure, and the direction, number, and selection of personnel.

Most school district employees have the right to bargain collectively

Most people employed in a school district, including teachers, principals, and nonlicensed staff, have the right to bargain collectively. Employees who choose not to organize do not have access to statutory bargaining protections. PELRA excludes school superintendents and certain part-time and temporary employees, and these excluded employees do not have the right to bargain collectively. PELRA does not apply to independent nonpublic contractors or their employees who provide pupil transportation, food service, or other contracted services to a school district.

PELRA organizes public employees into bargaining units, who represent them in contract negotiations

PELRA specifies criteria for determining appropriate bargaining units. For school districts, the law places all teachers, other than ECFE teachers, in a district in one bargaining unit. If principals and assistant principals organize, they are in a different bargaining unit. There are considerable variations among school districts in bargaining units for nonlicensed employees.

The Commissioner of the Bureau of Mediation Services is responsible for many administrative tasks under PELRA. The commissioner uses statutory criteria to determine appropriate bargaining units. The commissioner certifies exclusive representatives of employees, in most cases after an election. Currently, Education Minnesota is certified to represent bargaining units of licensed K-12 teachers in all Minnesota school districts.

Employees need not join a union. But PELRA requires the exclusive representative to represent both members and nonmembers, and lets unions impose a "fair share" fee of up to 85 percent of regular membership dues for services the union provides to all people the union represents.

Teachers' employment agreements are for a two-year term

Under PELRA, the length of a contract term is negotiable but must not exceed three years. However, PELRA requires teachers' collective bargaining agreements to be for a two-year term, beginning July 1 in an odd-numbered year. Teachers' collective bargaining agreements must establish teachers' compensation, including fringe benefits, for the entire two-year term and must not contain a wage reopening clause or other provision for renegotiating teachers' compensation during the two-year term.

PELRA provides several alternatives for resolving an impasse over contract terms

PELRA provides several alternatives for resolving an impasse between negotiating parties on contract terms:

- Either the school district or the exclusive representative of the teachers may ask the commissioner to provide nonbinding mediation to try to resolve a disagreement, and this frequently occurs.
- For essential employees (principals and assistant principals), either party can require the use of binding arbitration to decide contract terms after an impasse in bargaining has occurred. For other employees (teachers and nonlicensed employees), binding arbitration occurs only if the school board and the exclusive representative mutually agree on arbitration.
- Essential employees cannot strike. For others, the opportunity to strike exists if certain conditions are met: the collective bargaining agreement has expired, the parties participated in mediation over a period of at least 30 days, and no party requested interest arbitration or binding interest arbitration was rejected; or the employer refused to comply with a valid decision of a binding arbitration panel or arbitrator; and sufficient and timely notice was given.

Continuing contract laws establish procedural requirements and substantive grounds for terminating a teacher

Two statutory sections separate from PELRA govern probationary and continuing employment for licensed K-12 teachers in school districts generally (Minn. Stat. § 122A.40) and in the three first-class city school districts of Minneapolis, St. Paul, and Duluth (Minn. Stat. § 122A.41). These tenure or continuing contract statutes establish procedural requirements and substantive grounds such as inefficiency or neglect of duties for terminating a teacher's employment. These statutes allow a school board and the exclusive representative of the teachers to negotiate a plan for unrequested leaves of absence due to teacher cutbacks; statute and case law control if a plan is not negotiated. Collective bargaining agreements must not conflict with the substance of these statutes but may alter the statutory unrequested leave of absence provisions.

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

Lisa Larson Revised: July 2011

Minnesota's Charter School Law

A charter school is a public school with a specialized purpose that is exempt from some statutes and rules applicable to other public schools

A charter school is a public school, part of the state's system of public education, and subject to the high school graduation requirement. The law provides that a charter school's purpose is to enhance students' learning opportunities and achievement, improve teaching opportunities and methods, or improve school accountability measures. It must be nonsectarian and provide a comprehensive instructional program for at least one grade or age group of students. The school calendar must meet or exceed the number of instructional days provided to other public school students. A charter school may offer instruction throughout the school year under the flexible learning year or learning year program.

A charter school is exempt from statutes and rules applicable to a school, a school board, or a school district, except as provided in the charter school law or in another law made specifically applicable to charter schools.

Teachers, parents, and districts may form a charter school

With an authorizer, interested teachers and parents and district-created corporations may establish and operate a charter school or a school board may convert a school to a charter school if 60 percent of the school's full-time teachers petition the board. A charter school operator must incorporate as a nonprofit corporation. An initial board of directors must adopt articles and bylaws, and school staff and parents must elect an initial board of directors and an ongoing board within three years. Teachers may be a majority of board members. Board meetings are subject to the open meeting law. A charter school may be located in any school district unless the local school board objects.

An eligible authorizer must charter a school

Any one of five entities may authorize one or more charter schools: a school board, an intermediate school board, or an education district; certain charitable organizations; a Minnesota private college, a college or university that is part of the Minnesota State Colleges and Universities system, and the University of Minnesota; a nonprofit corporation; and single-purpose authorizers that are charitable organizations formed solely to operate charter schools. The Commissioner of Education has 45 business days to approve an authorizer's application to charter a school. An authorizer annually must monitor and evaluate the financial, operational, and student performance of the charter schools it authorizes. The authorizer may charge an evaluation fee. With commissioner approval, an authorizer may permit a charter school to expand to additional sites or add grades. An authorizer may or may not renew a charter school contract at the end of the term and may unilaterally terminate a contract during the term for cause. An authorizer is immune from civil and criminal liability for all activities related to a charter school. The commissioner must review an authorizer's performance at least every five years, may undertake more frequent reviews, and may take corrective action against an authorizer.

A charter school must have a contract

An authorizer and a charter school board of directors must sign a contract that at least specifies the program purpose, student outcomes, admissions requirements, an operating plan, compliance with federal and state laws, ongoing oversight of operational, financial, and academic performance, school evaluation criteria, liability insurance, an initial three-year contract that may be renewed for up to five years, applicable special education agreements, and a plan for an orderly school closing. The board of directors may sue and be sued.

A charter school receives state funding

A charter school receives general education and transportation revenue, special education and building lease aid, and other funds as though it were a school district. A charter school may use total operating capital revenue, accept funds for capital facilities needs, and apply for integration aid. It may not use state funds to purchase land or buildings. A charter school in statutory operating debt must have a plan to eliminate the debt. A charter school that notifies the commissioner by July 1 that it will transport students receives state transportation aid. A charter school need not transport students between a nonresident student's home and the border of the school district in which the charter school is located. A board of directors may not levy taxes or issue bonds. Conflicts of interest are prohibited and any board member who violates the prohibition is individually liable. A charter school is subject to the same financial audits and audit procedures as a school district. The commissioner must provide board members with financial management training.

A charter school may buy or lease a facility or may organize a nonprofit corporation to renovate, purchase, or construct a facility

A charter school may purchase land or buildings with nonstate funds and may lease instructional space from an eligible school board, a public or private nonprofit nonsectarian organization or other nonsectarian organization, or from a sectarian organization in some cases. A charter school with insufficient total operating capital revenue may receive state building lease aid to rent or lease a building or land. A charter school may organize an affiliated nonprofit building corporation to renovate or purchase an existing facility or to construct a new facility. To avoid any conflict of interest, a charter school may not enter into a lease with a related party unless the lessor is a nonprofit corporation and the lease cost is reasonable. The commissioner may recover excess lease payments when a charter school enters into a lease with a related party and later closes.

A charter school can be dissolved

When an authorizer unilaterally terminates or does not renew a charter school contract after notifying the board and conducting an informal hearing if requested, the charter school must be dissolved unless the commissioner approves a change to a different eligible authorizer. The commissioner may terminate a charter school contract for failing to meet pupil performance requirements, fiscal mismanagement, law violations, or other good cause. If an authorizer and a charter school agree to terminate or not renew a contract, the school must be dissolved unless the commissioner approves a change to a different eligible authorizer. Students enrolled in a charter school that is closed may enroll in the resident district or apply to a nonresident district under the open enrollment program; open enrollment application and notice deadlines do not apply in this case.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research information brief *Charter Schools*, November 2005.

Mark Shepard

Updated: August 2011

Legislative Review of State Employee Collective Bargaining Agreements

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

The commissioner of management and budget 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 management and budget 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 management and budget 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.

Matt Burress **Updated: August 2011**

County State-Aid Highway System

Overview

The county state-aid highway system is a network of key highways under the jurisdiction of Minnesota's counties. It covers roughly 30,500 miles, comprises just over two-thirds of all county highway miles, and includes roadways within all 87 counties. Counties receive money from the state's county state-aid highway (CSAH) fund for the construction, improvement, and maintenance of their highways included in the state-aid system. Under a 2008 change, two distinct formulas determine how much aid is allocated to each county.

Sources of revenue

State aid is provided through the CSAH fund, which is established by the Minnesota Constitution. Revenue mainly comes from taxes on motor fuels, motor vehicle registration, and motor vehicle sales. Available revenue consisted of $457.6 million in calendar year 2011, determined by both tax receipts to date and estimates of receipts for the remainder of the fiscal year. (This briefing does not discuss a CSAH fund "set-aside" that goes into town road, town bridge, and flexible highway accounts, some of which may also be provided to counties.)

Limitations on aid

Among the requirements accompanying the aid, counties must typically expend 60 percent of their allocation on construction projects and 40 percent on maintenance efforts. Minn. Rules part 8820.1400. Counties are also required to expend a share of their aid on stretches of county state-aid highways located within small cities having populations under 5,000. Minn. Stat. § 162.08, subd. 1. In general, the amount expended must at least be proportional, based on the construction needs for county state-aid highway segments located in a county's small cities compared to the total construction needs in that county's state-aid highway system.

Distribution of funds

Money in the CSAH fund is allocated on a calendar-year basis (using a combination of actual tax receipts and estimates). A portion is set aside as deductions for county highway-related purposes, including: (1) MnDOT administrative costs, (2) a disaster account, (3) a research account, and (4) a state park roads account. The calendar year 2011 deductions amounted to $16.2 million, or about 3.5 percent of the total in the fund.

Direct aid, at $441.4 million in calendar year 2011, is divided into two categories. The first is the **apportionment sum** and the second is the **excess sum**. Each category reflects a distinct revenue stream and follows separate statutory formulas to calculate aid distribution among the counties. Minn. Stat. § 162.07.

Apportionment sum revenue and distribution formula

The apportionment sum revenue consists of available CSAH fund dollars that are not identified as part of the excess sum (described below). The funds are distributed to counties following a statutory formula, so that:

- 10 percent of the apportionment sum is divided equally among all counties;
- 10 percent is proportional, based on motor vehicle registration in each county (compared to the total for all counties);

- 30 percent is proportional, based on county state-aid highway lane-miles (compared to the total for all counties); and
- 50 percent is proportional, based on county construction needs to bring the system up to county engineering standards. Minn. Stat. § 162.07, subd. 1b.

Excess sum revenue Excess sum revenue consists of the total from three sources:

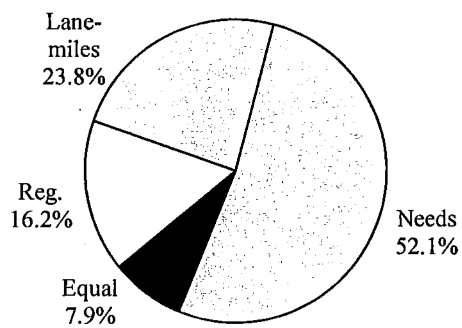
- revenue from motor fuels tax above the amount collected at a rate of 20 cents per gallon (which comprises new revenue from a motor fuels tax increase established in 2008 transportation finance legislation);
- revenue from the registration tax above the inflation-adjusted amount collected in fiscal year 2008 (which is designed to identify increased revenue resulting from registration tax changes also made 2008); and
- revenue from the motor vehicle sales tax above the percentage allocated to the CSAH fund in fiscal year 2007 (which is designed to reflect additional motor vehicle sales tax revenue currently being phased in for transportation purposes). Minn. Stat. § 162.07, subd. 1a.

Excess sum distribution formula The formula for distributing the excess sum is 40 percent proportional, based on motor vehicle registration in each county, and 60 percent proportional, based on each county's construction needs. Minn. Stat. § 162.07, subd. 1c.

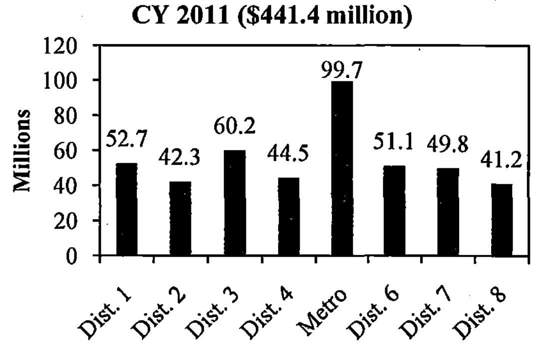
Analysis of formulas The apportionment and excess sum categories were introduced in 2008 as part of legislation that increased funding for transportation purposes. Laws 2008, ch. 152. The creation of two aid formulas was designed to address equity concerns in the statewide distribution of the aid.

For 2011, the excess sum consisted of $91.8 million or nearly 21 percent of the formula-based direct aid allocated to counties (that is, excluding deductions). However, in upcoming years the share of aid distributed under the excess sum formula—as opposed to the apportionment sum formula—is likely to increase a bit. This is because additional revenue is projected for transportation purposes due to recent legislation, and the increased revenue will mainly be distributed under the excess sum formula. The effect of the predicted revenue growth will likely be to de-emphasize the county lane-miles formula component and more heavily weight vehicle registration as well as construction needs.

Direct Aid Components
CY 2011 ($441.4 million)



Direct Aid by MnDOT District
CY 2011 ($441.4 million)



Matt Burress

Updated: August 2011

Municipal State-Aid Street System

The municipal state-aid street system is a collection of about 3,600 miles of key streets located in 147 Minnesota cities across the state. The system constitutes around 16 percent of all miles of city streets. Cities receive financial assistance from the state for construction and maintenance of those streets included in the system. Assistance comes from a portion of constitutionally dedicated, transportation-related taxes. Aid distribution is based on a statutory formula administered by the Minnesota Department of Transportation (MnDOT). Minn. Stat. § 162.13. The aid can only be expended on streets that constitute part of the municipal state-aid street system. Total available funds for calendar year 2011 amounted to $142.9 million.

Constitutional and statutory framework for state aid

The Minnesota Constitution establishes a basic framework for state highway finance. It (1) dedicates funding to be "used solely for highway purposes" through taxes on motor fuels, motor vehicle registration, and motor vehicle sales; (2) establishes various accounting funds, including a municipal state-aid street (MSAS) fund for financial assistance to cities; (3) allocates tax revenues among state, county, and municipal roads, so that the MSAS fund receives 9 percent of 95 percent of those tax revenues constitutionally dedicated to streets and highways (after some special allocations and transfers); and (4) establishes certain requirements related to use of the funds and characteristics each highway system. Minn. Const. art. XIV. State statutes further specify finance and policy provisions such as aid allocation formulas and requirements for cities to receive aid.

City eligibility

To be included in the system and receive aid, under the Minnesota Constitution a city must have a population over 5,000. Minn. Const. art. XIV, § 8. Population is determined by the last federal decennial census, with provisions for some special circumstances. Minn. Stat. § 162.09, subd. 4. Cities smaller than the population cutoff do not receive aid. (Chisholm's population fell below the cutoff with the 2000 census but is permanently grandfathered in. Laws 2001, 1st spec. sess., ch. 8, art. 2, § 6; Laws 2002, ch. 364, § 29.)

Based on drops in population under the 2010 census, five cities are anticipated to lose eligibility for aid from the MSAS fund (starting with the 2012 aid distribution). Roads in those cities may convert to city streets or become part of the county state-aid highway system under an agreement with the county.

While smaller cities having a population under 5,000 are not eligible for aid from the MSAS fund, they are indirectly assisted through separate funding for certain county highways. A portion of state funds for the county state-aid highway system provided to each county must be allocated to a municipal account for county state-aid highways located in smaller cities. Minn. Stat. § 162.08.

Street system limitations

Within each city, the municipal state-aid street system is restricted to up to 20 percent of the total miles of (1) the city's streets, plus (2) county highways located within the jurisdiction of that city. City streets that were previously part of a state trunk highway or a county highway system and were "turned back" to a city are also included in the municipal state-aid street system and do not count against the 20 percent limit. Minn. Stat. § 162.09.

Distribution of funds

State-aid funding is distributed on a calendar-year basis. MnDOT determines the amount annually based on both tax receipts to date and estimates of receipts for the remainder of that fiscal year. Apportionment amounts are released each January. For calendar year 2011, total available MSAS funding is $142.9 million.

Funds are distributed as follows based on formulas and caps set in state law:

- $139.1 million apportioned by formula as direct aid to cities;
- $2.9 million to an administrative account for MnDOT expenses in administering the state-aid program;
- $253,000 to a disaster account for unforeseen events resulting in undue financial hardship; and
- $633,000 to a research account. Minn. Stat. §§ 162.12, 162.13.

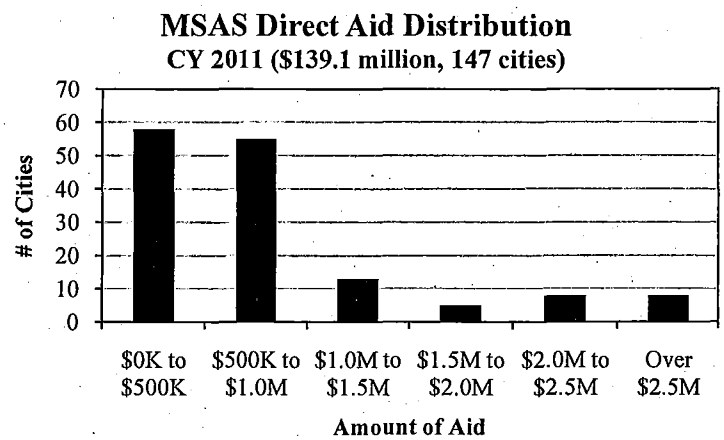
Direct aid allocation formula

Money in the MSAS fund apportioned to cities via direct aid follows a formula provided in statute, so that:

- **50 percent** is divided proportionally based on the population of each city (compared to the total for all cities); and
- **50 percent** is divided proportionally based on the construction needs of each city, which is the amount the city needs to bring all its municipal state-aid streets up to state standards. Minn. Stat. § 162.13.

Analysis of aid apportionment

Owing to the variety of cities with streets in the state-aid system, MSAS fund distributions vary. Calendar year 2011 direct aid apportionments to cities ranged from about $144,000 to over $12 million. The average allocation was just over $946,000, with 34 cities receiving over $1 million a piece and 16 cities receiving over $2 million. Because of the influence of population in the formula for allocating aid, larger cities tend to receive greater amounts of funding. The following chart groups cities based on amount of aid distributed.



For more information: Contact legislative analyst Matt Burress at 651-296-5045. Also see the House Research publication *Highway Finance Overview*, January 2011.

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

HOUSE RESEARCH | Short Subjects

Nina Manzi and Jim Cleary **Updated: August 2011**

Military Pay under Minnesota's Individual Income Tax

Several 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 nonmilitary income above the filing requirement for 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 by Minnesota residents, with nonmilitary income below the filing requirement

Minnesota residents who serve outside Minnesota and have nonmilitary income less than the filing requirement for the tax year ($9,500 for tax year 2011) 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 by Minnesota residents with nonmilitary income above the filing requirement

Minnesota residents who serve outside Minnesota and have nonmilitary income above the filing requirement for the tax year 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 have interest, dividend, or business income
- Members of the National Guard and reserves called to active service outside Minnesota for a portion of the tax year, who have civilian income in Minnesota during the remainder of the tax year

Service in Minnesota by a resident of another state

Individuals who serve in Minnesota and are residents of another state must file a Minnesota income tax return but may claim a subtraction for active service military pay 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. Federal law also prohibits states from considering spouses of residents of other states to be Minnesota residents for tax purposes.

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

Individuals who serve in Minnesota and are Minnesota residents 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 subtraction does not apply to Active Guard/Reserve (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 for 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 (National Guard), such as weekend drills and annual training (summer camp), special school attendance, 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 (Reserves), such as weekend drills, annual training (summer camp), special school attendance, pre- or postdeployment-related duty, and time on medical hold under Title 10 active duty orders while recuperating from an injury (Minn. Stat. § 190.05, subd. 5c).

"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.

Minnesota follows federal tax treatment of other kinds of military income and benefits

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 and qualifying for refunds.

For more information: The Department of Revenue maintains information on taxation of military pay online at taxes.state.mn.us/individ/pages/residency_and_filing_status_military_sub_active_duty_military.aspx; or contact legislative analyst Nina Manzi at 651-296-5204 or Jim Cleary at 651-296-5053.

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

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Nina Manzi and Joel Michael

Updated: August 2011

Section 179 Expensing under the Federal and Minnesota Income Tax

What is section 179 expensing?

Income tax laws generally require businesses to spread deductions of capital expenditures over the useful lives of the purchased property. Section 179 expensing, which takes its name from a section of the Internal Revenue Code, allows businesses to deduct the entire amount of the cost of qualifying property in the tax year the property is placed in service, rather than claiming depreciation deductions over a number of years. This allows the business to accelerate recognition of the expense from future tax years into the present year. The number of years over which property would otherwise be depreciated ranges from three to 15 years, depending on the type of property and its useful life as classified under the Internal Revenue Code.

How much can be claimed under section 179 expensing under the federal income tax?

In tax year 2011, businesses can claim up to $500,000 of property expenditures under section 179. If a business places more than $2 million of qualifying property in service in the tax year, the amount allowed under section 179 is reduced dollar for dollar by the amount over $2 million, so that businesses that place in service more than $2.5 million in qualifying property are not eligible for section 179 expensing. For tax years 2010 and 2011 only, businesses may claim up to $250,000 of expenditures for qualified real property as section 179 expensing.

What are the section 179 expensing allowances under the Minnesota income tax?

Minnesota does not conform to the federal section 179 expensing amount in effect in tax year 2011, and does not allow expenditures for qualified real property to be claimed as expensing. Instead, Minnesota allows the section 179 expensing amount in effect before tax year 2003, when the federal government embarked on a series of increases and extensions to the amount allowed as section 179 expensing.

In tax year 2011, a business may claim up to $25,000 in expensing on its Minnesota return. This amount is reduced dollar for dollar by the cost of property placed in service over $200,000, so that a business that places in service more than $225,000 in qualifying property is ineligible.

If a business claims more than $25,000 in section 179 expensing at the federal level, it must add 80 percent of the additional amount claimed to Minnesota taxable income on its Minnesota return. It is then allowed to subtract one-fifth of the amount added back in each of the next five tax years. In that way the full amount claimed at the federal level is ultimately allowed at the state level—20 percent in tax year 2011 and 16 percent per year in tax years 2012 through 2016.

What recent federal changes have been made in section 179 expensing?

In 2002 businesses could claim up to $24,000 in section 179 expensing, and this phased out for businesses with total expenses from $200,000 to $224,000. The $24,000 allowance was scheduled to increase to $25,000 in 2003, but Congress temporarily increased the allowance to $100,000. This was the first of nine Congressional actions that provided temporary increases in the maximum allowance and the "phaseout" limit; Congress has also periodically indexed for inflation the temporarily increased amounts. This legislation is summarized in the following table.

Summary of Federal Section 179 Legislation 2003-2012

Year	Maximum deduction	Phaseout	Indexing	Expiration
2003	$25,000, increased to $100,0000	$200,000, increased to $400,000	Yes for 2004 and 2005	2006
2004	No change	No change	Extended to 2006 and 2007	Extended to 2008
2006	No change	No change	Extended to 2008 and 2009	Extended to 2010
2007	Increased to $125,000	Increased to $500,000	Yes for 2008 to 2010	2011
2008 and 2009	Increased to $250,000	Increased to $800,000	No	2010
2010 and 2011	Increased to $500,000	Increased to $2 million	No	2012
2012	$138,000	$551,000	Yes, from 2007	2013

What is the recent history of section 179 expensing in Minnesota?

Minnesota conformed to the initial federal increase in section 179 expensing, which was effective for tax years 2003 through 2005. In those years, businesses could claim the same amount under the Minnesota tax as they could under the federal tax. Since then, the legislature has elected not to conform to the higher federal section 179 allowances.

Instead of conforming to the increased federal amounts, Minnesota law requires taxpayers to add to taxable income 80 percent of the additional amount of expensing allowed at the federal level in the first tax year, and then subtract one-fifth of the amount added back in each of the five following years.

What are the federal and state allowances?

Section 179 Allowances Under Federal and Minnesota Law

	Federal		Minnesota	
Tax year	Maximum deduction	Start of phaseout	Maximum deduction	Start of phaseout
2002	$24,000	$200,000	$24,000	$200,000
2003	100,000	400,000	100,000	400,000
2004	102,000	410,000	102,000	410,000
2005	105,000	420,000	105,000	420,000
2006	108,000	430,000	25,000	200,000
2007	125,000	500,000	25,000	200,000
2008-2009	250,000	800,000	25,000	200,000
2010-2011	500,000	2,000,000	25,000	200,000
2012	138,000	551,000	25,000	200,000

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

HOUSE RESEARCH | Short Subjects

Kathy Novak and Nina Manzi **Updated: August 2011**

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of Minnesota Management and Budget 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 2010 forecast provided the revenue and expenditure projections that the governor used in developing the budget for the fiscal year 2012-2013 biennium. The November 2010 forecast also showed if the state was on track to finish the fiscal year 2010-2011 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 2011 forecast provided the revenue and expenditure projections that the legislature used in adopting a budget for the fiscal year 2012-2013 biennium. Following the February forecast, Gov. Mark Dayton submitted modifications to the budget developed from the November forecast, which are called "supplemental budget recommendations." The February 2011 forecast also provided 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 2011 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2012-2013 budget during the 2012 legislative session. The legislature will use the projections in the February 2012 forecast to ensure that the fiscal year 2012-2013 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 Minnesota Management and Budget 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, and if a balanced budget has been enacted for the biennium, then 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 Minnesota Management and Budget 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 revenue and expenditure changes in order for the budget to be in balance at the close of the coming biennium.

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 Minnesota Management and Budget 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
- to restore the $15 million transferred in 2008 from the state airports fund to the general fund
- to restore the additional $10.7 million transferred in 2010 from the fire safety account in the special revenue fund to the general fund

If all these priorities have been met, the remaining surplus is reported in the forecast as a "positive unrestricted budgetary general fund balance." Recent budget balancing actions affect the priorities and distribution of surplus funds.

On July 1, 2011, the commissioner of Minnesota Management and Budget canceled $171 million of the unobligated balance in the cash flow account to the general fund, reducing it below the required level of $350 million. The budget reserve has been reduced to zero as part of balancing the fiscal year 2012-2013 budget. The school aid payment schedule is set at 73 percent for fiscal year 2010, 70 percent for fiscal year 2011, and 60 percent for fiscal year 2012 and following years. Any positive unrestricted budgetary general fund balance in future forecasts would go first toward restoring the cash flow account to $350 million, then to restoring the budget reserve account, until it reached $653 million, and next to increasing the school aid payment percentage to 90 percent.

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,* December 2010.

Danyell Punelli Revised: August 2011

Basics of Emergency General Assistance

Emergency General Assistance (EGA) is a state program, administered by Minnesota counties, that provides income assistance in emergency situations.

Who is eligible?

An individual, childless couple, or family without financial resources immediately available to resolve an emergency situation is eligible for EGA if:

- The person or family is not eligible for Minnesota Family Investment Program (MFIP), the Diversionary Work Program (DWP), or county emergency assistance through the MFIP consolidated fund;
- The person or family has annual net income no greater than 200 percent of the federal poverty guidelines (FPG) for the pervious calendar year (in 2010, for a family of three, 200 percent of FPG was $36,620);
- The person or family has not, without financial good cause, used more than 50 percent of available income and resources for purposes other than basic needs during the 60 days before application;
- The person or family is without financial resources immediately available to resolve the emergency; and
- The emergency did not arise because the person or family member has been disqualified from General Assistance (GA) or MFIP.

Persons or families in need who are not state residents may also receive assistance to meet emergency needs. State law requires that nonresidents must reside in Minnesota for 30 days before applying for EGA.

Beginning November 1, 2011, applicants for or recipients of Supplemental Security Income (SSI) or Minnesota Supplemental Aid who have emergency need may apply for EGA. This change was made by the 2011 Legislature as part of a restructuring and combining of emergency assistance programs.

An individual or family may receive EGA not more than once in any 12-month period.

What is an "emergency situation"?

An emergency situation is a situation in which an individual or family is without, or will lose within 30 days after application, a basic need item and requires immediate financial assistance. "Basic needs" are limited to food, clothing, shelter, utilities, and other items, the loss or lack of which pose a direct, immediate threat to the physical health or safety of the applicant.

The assistance must be temporary and must not exceed 30 days following the date of application. Assistance must be paid for needs that accrue before the 30-day period when it is necessary to resolve emergencies arising or continuing during the 30-day period.

How is EGA funded and how are benefits paid?

EGA is funded with state general fund dollars. State funding for EGA was unalloted by Gov. Tim Pawlenty beginning November 1, 2009, through June 30, 2011.

EGA is provided within the limits of available appropriations and funds are allocated to counties by the state. The minimum county allocation is $1,000 per fiscal year. Counties may make expenditures above the amount of their state allocation but additional expenditures must be made from county funds.

EGA grants are paid for with vouchers or in the form of a vendor payment unless the county determines that a cash grant will better meet the needs of the emergency situation.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058. Also see the House Research publication *Minnesota Family Assistance*.

Danyell Punelli September 2011

2011 Corporate Foster Care Moratorium Modifications

Corporate foster care is foster care in which the primary license holder does not reside in the residence, and the foster care home is operated by a corporation with shift staff delivering services to clients. The 2009 Legislature established a partial moratorium on new licenses for corporate foster care. The 2011 Legislature made changes to the moratorium that are briefly described in this short subject.

What is the corporate foster care moratorium?

Beginning July 1, 2009, the commissioner of human services was prohibited from assigning initial licenses for corporate foster care. Exceptions to the moratorium include:

- foster care settings that are required to be licensed under the housing with services establishment statute;
- foster care licenses replacing foster care licenses in existence on May 15, 2009, and determined to be needed by the commissioner;
- new foster care licenses determined to be needed by the commissioner for the closure of a nursing facility, intermediate care facility for persons with developmental disabilities, regional treatment center, or restructuring of state-operated services that limits the capacity of state-operated facilities;
- new foster care licenses determined to be needed by the commissioner for persons requiring hospital level care; and
- new foster care licenses determined to be needed by the commissioner for the transition of people from personal care assistance to the home- and community-based services.

Who is affected by the changes to the corporate foster care moratorium?

The 2011 Legislature modified the corporate foster care moratorium by directing local agency case managers, at the time of reassessment, to assess recipients of the Medicaid Community Alternatives for Disabled Individuals (CADI) and Traumatic Brain Injury (TBI) waivers currently residing in corporate foster care to determine if they may be appropriately served in a community-living setting (see definition below).

If a community-living setting is determined appropriate for the recipient, the case manager must offer the recipient the option to receive alternative housing and service options. The recipient has the choice to stay in corporate foster care or transfer to a community living setting. (See Laws 2011, 1st spec. sess., ch. 9, art. 7, § 40.)

When must the reassessments be completed?

Local agency case managers must complete these reassessments by June 30, 2012. Generally, a reassessment of an individual's strengths, support systems, and need for services is conducted at least every 12 months and at other times when there has been a significant change in the individual's functioning.

How are "community-living settings" defined?

"Community-living settings" are defined as single-family homes or apartments where the service recipient or their family owns or rents, and maintains control over, the individual unit. Community-living settings must meet the following criteria:

- individuals must not be required to receive services through the housing provider
- individuals must not be required to have a disability or specific diagnosis to live in the setting
- individuals may choose whether to share their household and with whom
- individuals must have lockable access and egress (See Laws 2011, 1st spec. sess., ch. 9, art. 7, § 41.)

What other requirements must local agencies meet?

Counties are required to immediately inform the Department of Human Services (DHS) when a corporate foster care recipient receiving services through the CADI or TBI waivers chooses to move out of a corporate foster care home into a community-living setting. DHS must immediately decrease the licensed capacity for that home. These decreases in licensed capacity are not subject to appeal. (See Laws 2011, 1st spec. sess., ch. 9, art. 7, § 1.)

What happens to the vacated beds?

The new law prohibits vacated corporate foster care home beds from being filled with other recipients of Medicaid waiver services or group residential housing. It also requires the licensed capacity of the corporate foster care home to be reduced when an individual chooses to move to a community-living setting, with certain exceptions. If a corporate foster care home becomes no longer viable due to the transfer of CADI and TBI recipients to community-living settings, the county agency and DHS must facilitate a consolidation of settings or closure of the facility. (See Laws 2011, 1st spec. sess., ch. 9, art. 7, § 40.)

What is the impact of this change?

DHS estimates that 128 individuals will move out of corporate foster care and into a community-living setting in the current biennium as a result of this change in the law.

Does this save the state money?

This change results in an estimated savings of $1.29 million in fiscal years 2012 and 2013, and $4.17 million in fiscal years 2014 and 2015.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058.

Mark Shepard September 2011

The Minnesota Sunset Act

The 2011 Legislature created a Sunset Advisory Commission, which will periodically review state agencies and make recommendations on whether the agency should continue to exist. The law, called the Minnesota Sunset Act, establishes a schedule for periodic review and expiration of many state agencies (Minnesota Statutes, chapter 3D).

Some agencies expire automatically unless reauthorized by law

Most state executive branch agencies will be reviewed between 2012 and 2022, according to a schedule prescribed in law. Many agencies, including most state boards, councils, and commissions, expire automatically at the scheduled date unless a new law continues the agency. The following agencies will be reviewed according to the schedule but do *not* expire automatically:

- Administration
- Agriculture
- Commerce
- Corrections
- Education
- Employment and Economic Development
- Explore Minnesota Tourism
- Health
- Higher Education
- Housing Finance
- Human Rights
- Human Services
- Iron Range Resources and Rehabilitation
- Labor and Industry
- Management and Budget
- Mediation Services
- Military Affairs
- Natural Resources
- Pollution Control
- Public Safety
- Public Utilities Commission
- Revenue
- Transportation
- Veterans Affairs

The Sunset Advisory Commission must review agencies

The Sunset Advisory Commission must review agencies at the scheduled times and make recommendations to the legislature. The commission's recommendations are advisory—the commission does not have authority to extend an agency that is scheduled for automatic expiration or to abolish an agency that is not scheduled to expire automatically.

The commission consists of four senators, four members of the House of Representatives, and four members appointed by the governor. No more than three of the senators and no more than three of the House members may be from the majority caucus in their respective chambers. All members serve at the pleasure of the appointing authority. The commission must review all agencies, even the agencies that do not expire automatically. The law assigns each agency to one of six groups, which are scheduled for review in 2012, 2014, 2016, 2018, 2020, and 2022. Advisory groups associated with an agency expire at the same time as the agency.

The following agencies are in the first group, which is subject to review starting in

2011. These agencies are scheduled to expire on June 30, 2012:

- Amateur Sports Commission
- Capitol Area Architectural and Planning Board
- Combative Sports Commission
- Council on Asian-Pacific Minnesotans
- Council on Black Minnesotans
- Council on Affairs of Chicano/Latino People
- Council on Disabilities
- Indian Affairs Council
- All health-related licensing boards
- All advisory groups associated with these agencies

The law establishes a process to be followed each review cycle

In each review cycle, the following must occur:

- Agencies subject to review must report statutorily specified information to the commission by September 1 of the odd-numbered year (The September 1 deadline does not apply in 2011)
- Before January 1 of the year in which an agency is sunset, the commission must review the agency, according to criteria specified in law. These criteria include consideration of the agency's efficiency and effectiveness, if there are alternative means of performing agency functions, and if there is duplication and overlap with other agencies.
- Before February 1 of the year an agency is sunset, the commission must conduct public hearings and make recommendations to the legislature on possible continuation of the agency
- During the even-year legislative session, the legislature may enact a new law providing that an agency does not expire, or (with respect to those groups that automatically expire) may do nothing and thus let the agency expire

The law specifies what happens if an agency expires

The law provides that if an agency expires according to schedule on June 30 of an even-numbered year, the agency may continue to exist until June 30 of the following year, during which time the agency retains all of its powers and authority. Unless a law is enacted providing otherwise, the following occur on June 30 of the odd-numbered year:

- Statutory duties, property, and records of an abolished agency are transferred to the Commissioner of Administration, who is required to perform necessary administrative functions of the abolished agency
- Rules adopted by the abolished agency remain effective and must be enforced by the Commissioner of Administration
- The Commissioner of Administration may use statutory reorganization authority to transfer duties of an abolished agency to a different executive branch agency
- If an appropriation exists for functions or obligations transferred from the abolished agency, that appropriation is transferred to the Commissioner of Administration

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

Mark Shepard

Updated: September 2011

State Elected Officials' Compensation

Salaries for the governor, lieutenant governor, attorney general, state auditor, secretary of state, judges, and legislators are established by state law and by the legislature, depending on the position.

Salaries for constitutional officers

As required by the Minnesota Constitution, salaries for constitutional officers are prescribed by law. Art. V, § 4. Current annual salaries are as follows:

Officer	Salary	% of Governor's Salary
Governor	$120,303	---
Attorney General	$114,288	95%
State Auditor	$102,258	85%
Secretary of State	$90,227	75%
Lieutenant Governor	$78,197	65%

The most recent salary increases were in January 2003, when a law took effect establishing salaries for constitutional officers as a percentage of the governor's salary. Laws 2001, 1st spec. sess., ch. 10, art. 1, § 2. The most recent salary increase for the governor was 2.5 percent in January 1998.

The governor can veto legislation establishing compensation for constitutional officers because, according to the constitution, the compensation is set "by law."

Salaries for judges

The Minnesota Constitution stipulates that the legislature should establish compensation for judges and that judges' salaries cannot be reduced while they are in office. Art. VI, § 5. The most recent salary increases for judges were 3 percent, and took effect in July 2008 as required under a 2007 law. Laws 2007, ch. 54, art. 1, § 3. Annual salaries for various judges are as follows:

Official	Salary
Supreme Court, chief	$160,579
Supreme Court, justice	$145,981
Court of Appeals, chief	$144,429
Court of Appeals, justice	$137,552
District Court, chief	$135,580
District Court, judge	$129,124

The constitutional provisions governing judges have been interpreted to mean that the governor may not veto provisions setting judges' compensation because their compensation is prescribed "by the legislature." *Gardner v. Holm*, 241 Minn. 125, 62 N.W. 2d 52 (1954).

Salaries for legislators

The Minnesota Constitution provides that legislators' compensation is set by law. The annual salary for representatives and senators is $31,140. The House and the Senate each can designate three leadership positions to receive up to 140 percent of the compensation of other members of the legislature (this is an additional $12,456 per year).

The most recent salary increase for legislators was 5 percent in January 1999. The constitution also says that "no increase of compensation shall take effect during the period for which the members of the existing House of Representatives may have been elected." Art. IV, § 9. Because the constitution says that legislators' salaries are set "by law," the governor can veto legislation setting legislators' compensation.

Legislative per diem

In addition to salary, legislators are eligible to receive a per diem payment when engaged in official business. The House rate is $77 per day and the Senate rate $86 per day.

The compensation council's role in establishing salaries

The legislature has established a 16-member compensation council to assist it in establishing the compensation of constitutional officers, judges, and legislators. Minn. Stat. § 15A.082. A new compensation council is created in the fall of each even-numbered year; the new council must make its recommendations to the legislature by May 1 of the odd-numbered year.

By law, the council's recommendations take effect if an appropriation to pay the recommended salaries is enacted after the recommendations are submitted and before their effective date. As a practical matter, when the legislature has increased salaries, it generally has done so either by expressly adopting or modifying compensation council recommendations or by establishing percentages in law without reference to compensation council recommendations.

Insurance benefits and pension plans

Constitutional officers, legislators, and judges all are members of the state employee group insurance plan and receive the same insurance benefits as state employees.

Most legislators (all who were first elected after July 1, 1997, and some elected before then) and all constitutional officers are members of a defined contribution pension plan. Under this plan, the member contributes 5 percent of his or her salary and the state contributes 6 percent. This money is invested, and upon leaving state service, the elected official is eligible to receive whatever money is in the account.

Judges belong to a defined benefit pension plan, in which the benefit is determined by multiplying years of service times a service-credit percentage and applying this percentage to the judge's average high-five years of salary.

For more information: Contact legislative analyst Mark Shepard at 651-296-5051. For historical information on elected officials' salaries, see the Legislative Coordinating Commission's website: www.commissions.leg.state.mn.us/lcer/officialssalaries.htm.

Lynn Aves

Updated: September 2011

Child Care Licensing

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

Who must be licensed?

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

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

- services provided to children who are related to the child care provider
- services provided by an unrelated individual to children from a single related family member
- programs operated by a public school for children 33 months or older
- services provided for children for periods of less than three hours a day while the child's parent is in the same or contiguous building
- recreation programs for children that are operated or approved by a park and recreation board
- programs operated by a school, YMCA, YWCA, or JCC whose primary purpose is to provide child care or services to school-age children
- Head Start nonresidential programs that operate for less than 45 days in a year
- services provided to children for a cumulative total of less than 30 days in any 12-month period
- programs for children such as scouting, boys clubs, girls clubs, sports and arts programs
- the religious instruction of school-age children
- Sabbath or Sunday schools, or congregate care of children of any age by a church, congregation, or religious society during the period the church, congregation, or religious society uses for its regular worship
- programs operated by an accredited nonpublic school for children 33 months or older for no more than four hours per day per child, with no more than 20 children present at one time

What is the purpose of licensing?

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

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

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

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

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

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

The local county social services or human services agency:

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

Who should individuals call if they have questions?

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

HOUSE RESEARCH | Short Subjects

Deborah A. Dyson

Updated: September 2011

Terms Used in Local Government Legislation

Minnesota statutes and laws use a number of terms to refer to local governmental units, and from one law to another they may not mean the same thing. This is a summary of commonly used terms and cautions regarding their definitions.

Local government "Local government" usually refers to counties, towns, and cities. Single- or multi-purpose special districts, such as school districts, are frequently included in the term "political subdivision" but are less often defined as local governments. Sometimes, absent a definition, only the context of the law will indicate what entities are meant to be included.

Political subdivision "Political subdivision" is probably the broadest term used to describe any public body that is not state or federal government. However, a statute may define the term to mean specific entities.

Public corporation "Public corporation" is used in two broad senses but is not defined in statute. In the context of local government, it means an entity created for the administration of public affairs, an instrumentality of the state, and may include counties, cities, towns, and special purpose entities. It also applies to quasi-governmental entities, created in law and often exempt from some laws that apply to state agencies. See, e.g., Enterprise Minnesota, Inc. Minn. Stat. § 116O.03, subd. 1.

Municipal corporation In the narrowest sense, a municipal corporation is a city. However, the term can be defined for the purposes of a law to include other governmental units.

City: statutory or home rule charter; classification **There are two types of cities in Minnesota: statutory and home rule charter.** A statutory city is governed by statute and any special laws enacted for that city.

A home rule charter city is governed by its charter and any special laws enacted for that city. Also, if the home rule charter is silent on a matter that is addressed for statutory cities by general law, and general law does not prohibit a city charter from addressing the matter or expressly provide that a city charter prevails over general law, then the city may apply the general law on the matter. Minn. Stat. § 410.33.

"In any law adopted after July 1, 1976, the word 'city' when used without further description extending the application of the term to home rule charter cities means statutory cities only." Minn. Stat. § 410.015.

Classification: Cities are divided, for legislative purposes, into classes as follows:

- First class: over 100,000 inhabitants; once a city is defined to be of the first class, it is not reclassified unless its population decreases by 25 percent from the census figures that last qualified the city for inclusion in the class

- Second class: 20,001 to 100,000 inhabitants
- Third class: 10,001 to 20,000 inhabitants
- Fourth class: not more than 10,000 inhabitants

Changes in classification take effect after the federal decennial census. Minn. Stat. § 410.01.

"Village" and "borough" are obsolete terms. All villages and boroughs in the state became statutory cities in the early 1970s.

Municipality This term generally means a city but many statutes define it to include other entities. For example, the uniform municipal contracting law defines "municipality" to mean "a county, town, city, school district or other municipal corporation or political subdivision of the state authorized by law to enter into contracts." Minn. Stat. § 471.345, subd.1.

County "County" rarely needs additional definition except to limit its application or to define it as a shorthand reference to the county board or some other entity covered by the law.

Town, township, urban town "Town" and "township" are used interchangeably in Minnesota law. As in other states, Minnesota towns are based on the congressional township—generally 36 square miles. Organized towns are the primary local government unit for unincorporated areas. Urban towns are those towns that have been granted some of the same powers as statutory cities.

Incorporated, unincorporated In the context of governmental units, "incorporated" means a city and "unincorporated" means a town. See Minnesota Statutes, chapter 414, governing municipal incorporations and boundary adjustments.

Interpretation of statutes, definitions "When a county, town, or city is mentioned, without any particular description, it imports the particular county, town, or city appropriate to the matter." Minn. Stat. § 645.44, subd. 3.

Metropolitan area There are at least two definitions of "metropolitan area" used in state law. One means the seven-county area of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington counties that is within the jurisdiction of the Metropolitan Council. Minn. Stat. § 473.121, subd. 2.

The second definition is "metropolitan statistical area (MSA), defined by the federal Office of Management and Budget (OMB) using OMB standards applied to U.S. Census Bureau data. The Minneapolis-St. Paul-Bloomington MSA includes 11 Minnesota counties (the seven named above and Chisago, Isanti, Sherburne, and Wright), and the Wisconsin counties of Pierce and St. Croix. Updates and changes in the definitions of MSAs are published in OMB Bulletins.

For more information: Contact legislative analyst Deborah A. Dyson at deborah.dyson@house.mn.

Matt Gehring Updated: September 2011

How a Constitutional Amendment Is Proposed and Ratified

A constitutional amendment is a change to the state's constitution that is decided by voters in an election. Since 1858, 213 constitutional amendments have been voted on by the electorate. The most recent constitutional amendment that was approved by voters came in 2008, when voters approved a tax to fund natural resources, arts, and cultural heritage projects.

The Minnesota Constitution and election statutes govern the process of proposing and ratifying amendments.

The legislature passes an act to change the constitution

First, the legislature passes an act proposing a change in the constitution. A constitutional amendment is just like a session law, but does not require the governor's signature, and a governor's veto has no effect. The act includes the statement of the question the legislature wants placed on the ballot. The constitution requires that the act be assigned a session law chapter number, published with other legislative acts of the same year, and presented to the voters at a general election. Each amendment must be submitted separately.

Proposed amendments appear on the ballot at the next state general election

The secretary of state, with approval of the attorney general, prepares a short title to identify each amendment on the ballot. The ballot question specified by the legislature appears under the title. The text of the constitution as it would appear if amended is not printed on the ballot. Sample copies of the ballot are available for public examination at the secretary's office and each county auditor's office before the state general election.

Constitutional amendment ballot questions appear on the ballot just after the listing of state offices, before the listing of county offices.

Current administrative rule requires that, if multiple amendments are proposed at an election, each amendment be assigned a number and appear chronologically in that order on the ballot.

During the 1990s, questions were assigned numbers and placed on the ballot in the order they passed the legislature. (Multiple amendments have not been proposed at the same election since 1998.)

Amendments must be approved by a majority voting in an election, not just a majority voting on the amendment

Since 1900, the constitution has required the approval of a majority of those voting at the election—not just a majority of those voting on the amendment question—to ratify the amendment. Thus, if a person votes at the election, failure to vote on an amendment is the equivalent of a "no" vote. A notice to this effect is printed on the ballot. Historically, it has taken roughly a 60 percent "yes" vote to pass an amendment.

If the state canvassing board finds that a proposed amendment received the approval of a majority of the voters at the election, the amendment takes effect immediately unless the amendment specified a later effective date.

For more information: Contact legislative analyst Matt Gehring at 651-296-5052.

Matt Gehring

Updated: September 2011

Campaign Finance and Public Disclosure Board Appointments

The Campaign Finance and Public Disclosure Board oversees the law on campaign finance and disclosure, lobbyist reporting, economic interest statements, and conflicts of interest.

How are board members appointed and approved?

The board consists of six members, appointed by the governor. After appointment, an appointee must be approved by three-fifths of the total membership of the House and three-fifths of the total membership of the Senate, acting separately.

Members of the Campaign Finance and Public Disclosure Board are the only gubernatorial appointees subject to the approval of both bodies of the legislature.

Nominees are typically selected through the state's open appointments process. The chair and the vice chair of the board are elected, from its own membership, by the board itself.

What is the deadline for approving appointments?

Appointments may be made by the governor at any time when there is or will be a vacancy. The deadline for approval by the legislature is the earlier of 45 legislative days after appointment, or adjournment sine die. A legislative day is a day that either the House or Senate meets in session during a biennium.

- If either house fails to act on approval of an appointee within that time period, the appointment terminates the day after the 45th legislative day or adjournment sine die, whichever applies.
- If either house votes not to confirm an appointment, the appointment terminates the day after the vote not to confirm.

What are the membership requirements for the board?

The board members must meet the following requirements:

- The remaining two members must be former legislators of different parties
- Two must be persons who have not been public officials as defined by law, held any political party office other than precinct delegate, or been elected to a partisan office in the three years before the appointment
- Two must support different political parties
- Overall, no more than three board members may support the same political party
- No board member may be a lobbyist while serving on the board

Board members (and all board employees) are subject to the same restrictions in law on political activities that apply to other state employees. In addition, a member or board employee may not be a candidate for (or holder of) an elected public office for which party designation is required, or a candidate for or office holder of an office at the national, state, congressional district, legislative district, county, or precinct level in a political party.

How long do board members serve?

Board terms are four years and end the first Monday in January.

How are vacancies handled?

Vacancies are filled by appointment for the duration of the time left in the term. The new appointee must meet the criteria met by the departed member. The approval process for individuals filling vacancies is the same as for members appointed to a full term.

Do board members receive compensation?

Members receive $55 per day if authorized by the board, plus expenses authorized by the Commissioner of Management and Budget's plan.

Members who are full-time state or local government employees may not receive the daily payment and may receive child care reimbursement only for time outside normal work hours. These individuals must not suffer loss in compensation or benefits as a result of board service and may receive expense reimbursement from the board unless compensated by another source.

May board members be removed?

The governor may remove a member during a term: (1) for cause, after notice and hearing, or (2) after the member misses three consecutive meetings.

For more information: Contact legislative analyst Matt Gehring at 651-296-5052.

HOUSE RESEARCH | Short Subjects

Danyell Punelli

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Child Care Assistance

What is child care assistance?

Child care assistance programs subsidize the child care expenses of eligible low-income families. The Minnesota Department of Human Services administers two child care assistance programs: Minnesota Family Investment Program (MFIP) child care assistance and Basic Sliding Fee (BSF) child care assistance. MFIP child care subsidizes the child care costs of families receiving cash assistance through MFIP and provides child care assistance for eligible families for the first 12 months after the family leaves MFIP cash assistance (transition year child care). BSF child care provides a child care subsidy to low-income working families who are not receiving cash assistance from MFIP.

What are the eligibility requirements for child care assistance?

To be eligible for child care assistance, both parents (or one parent in single-parent households) must participate in an authorized work, education, or training activity, cooperate with child support enforcement, and meet income eligibility guidelines. The maximum income limit to be eligible for child care assistance is 47 percent of state median income at program entry and 67 percent or less of state median income at program exit. (For fiscal year 2011, 47 percent of state median income was $34,348, and 67 percent of state median income was $48,964 for a family of three.)

Children up to age 12 are eligible for child care assistance (up to age 14 for disabled children). During fiscal year 2010, there were an average of 1.78 children per family receiving MFIP child care assistance and 1.77 children per family receiving BSF child care assistance.

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

What is the average annual subsidy a family receives?

In fiscal year 2011, the estimated average annual subsidy for a family receiving MFIP child care assistance was $11,537, and the estimated average annual subsidy for a family receiving BSF child care assistance was $9,615.

Every year, the Commissioner of Human Services conducts a survey of rates charged by child care providers to determine the 75th percentile maximum rates for similar care in a county, multicounty region, or category that the commissioner deems to be similar. However, maximum provider reimbursement rates have been frozen since 2003, with only a couple of increases since that time. The 2011 Legislature decreased provider reimbursement rates by 2.5 percent, effective October 31, 2011.

Are families required to pay for some child care expenses?

There is a family co-payment requirement based on family size and income. The maximum family co-payment is about 14 percent of gross monthly income. Families with incomes below 75 percent of the federal poverty level are exempt from making co-payments ($13,898 and below for a family of three in 2011).

How is child care assistance funded?

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

How many families receive child care assistance?

During fiscal year 2011, an estimated average of 9,800 families received MFIP child care assistance and 11,290 families received BSF child care assistance per month.

Not all families who apply for child care assistance receive it. MFIP child care is a forecasted, fully funded program, while BSF child care receives a capped allocation. As of June 30, 2011, there were 5,015 families on the waiting list for BSF child care assistance.

What are some potential legislative issues?

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

In recent years, there have been several attempts to increase maximum provider rates due to the rate freeze that has been in effect since 2003. Maximum reimbursement rates continue to be below the previous level of the 75th percentile for similar care in a country or region. There has also been interest in establishing a statewide quality improvement and rating system and a common set of quality standards for child care and other early childhood programs. These issues continue to be discussed.

For more information: See the House Research publication *Funding to Support Child Care Assistance*, July 2009.

Matt Gehring

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Recall of State Elected Officials

What is recall?

Recall is a method for removal of an elected official from office before the end of the official's term. Recall is one of four ways that a state elected official can be removed from office. The other methods are "impeachment" for constitutional officers and judges; "removal" for judges; and "expulsion" or "exclusion" from office for legislators. Recall is detailed in Minnesota Statutes, chapter 211C, and article 8, section 6 of the Minnesota Constitution.

In 1996, Minnesotans approved a constitutional amendment allowing recall of state officials, but to date none have been subject to a recall election.

Who may be recalled?

State representatives, state senators, the governor, the lieutenant governor, the secretary of state, the state auditor, the attorney general, supreme court judges, court of appeals judges, and district judges are all subject to recall. (Minnesota law also allows for recall of certain county officials. That process is not covered here. For more information see Minnesota Statutes, sections 351.14 to 351.23.)

What actions constitute grounds for recall?

A recall is permitted for "malfeasance," "nonfeasance," and "serious crime."

- **Malfeasance** means intentionally doing something unlawful or wrong while performing duties of the office; the act must be substantially outside of the scope of duties and substantially infringe upon another's rights.
- **Nonfeasance** means intentionally and repeatedly not performing required duties of the office.
- **Serious crime** means a crime that is a gross misdemeanor and involves assault, intentional injury, threat of injury, dishonesty, stalking, aggravated driving while intoxicated, coercion, obstruction of justice, or the sale or possession of controlled substances. Serious crime also means a misdemeanor crime that involves assault, intentional injury or threat of injury, dishonesty, coercion, obstruction of justice, or the sale or possession of controlled substances. An individual who is convicted of a felony is automatically removed from office, so a felony conviction is not specified as grounds for recall.

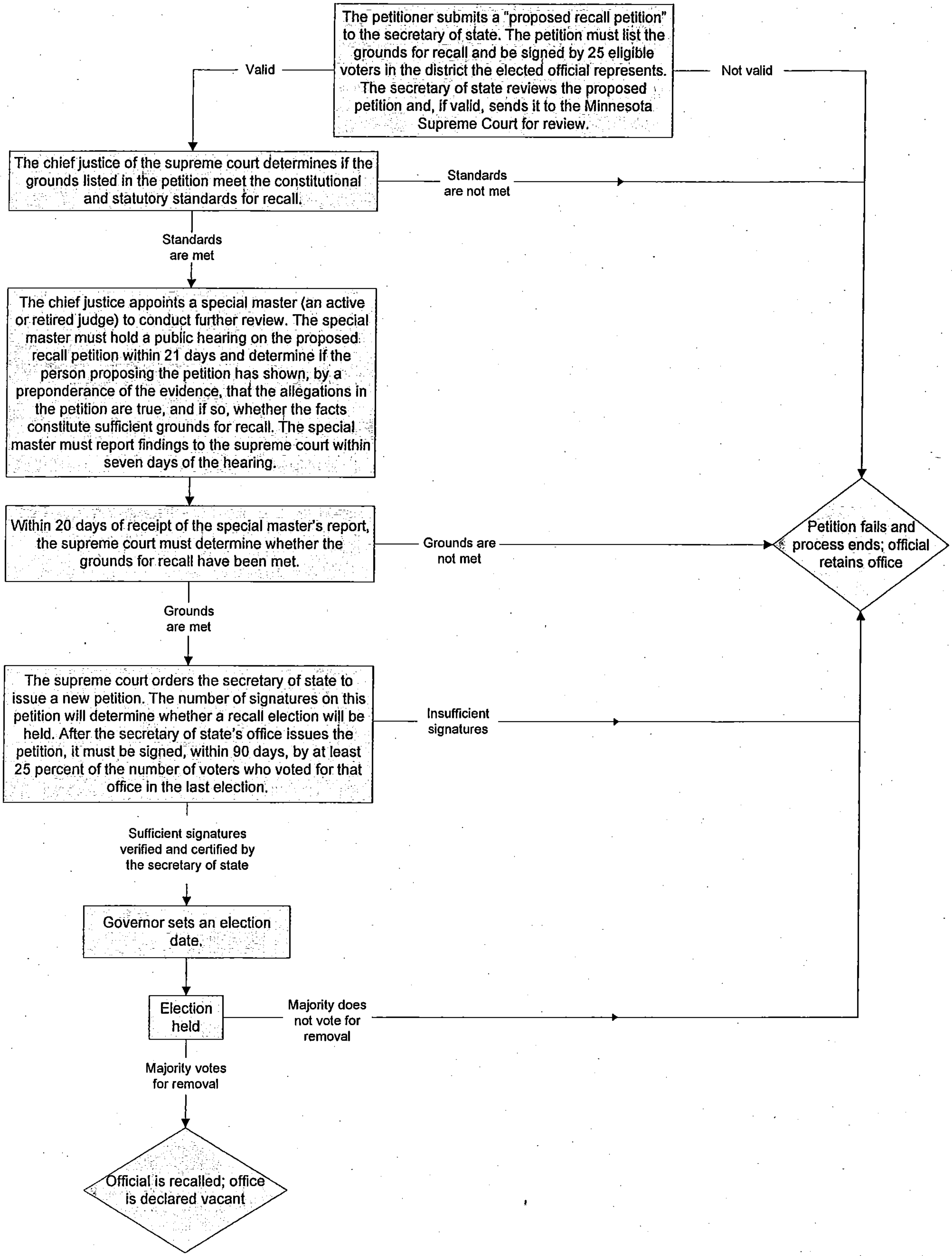
Grounds for recall for state officers, except for judges, are defined in Minnesota Statutes. The Minnesota Supreme Court subsequently adopted the same standards for recall as were established for state officers in the statutes, except that the supreme court's standards explicitly provide that a judge may not be recalled for the discretionary performance of a lawful act or a prescribed duty.

Are there restrictions on the recall process?

A person may not falsely allege wrongdoing by a state officer in a recall petition, or threaten, intimidate, coerce, or bribe eligible voters to sign or not sign a petition.

A recall election may not be held if there are fewer than six months remaining in an official's term. Only one recall petition may be active for any one office at a time.

Process for Recalling an Elected Official



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.

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HOUSE RESEARCH | Short Subjects

Mark Shepard **Updated: October 2011**

State Elected Officials' Compensation

Salaries for the governor, lieutenant governor, attorney general, state auditor, secretary of state, judges, and legislators are established by state law and by the legislature, depending on the position.

Salaries for constitutional officers

As required by the Minnesota Constitution, salaries for constitutional officers are prescribed by law. Art. V, § 4. Current annual salaries are as follows:

Officer	Salary	% of Governor's Salary
Governor	$120,303	---
Attorney General	$114,288	95%
State Auditor	$102,258	85%
Secretary of State	$90,227	75%
Lieutenant Governor	$78,197	65%

The most recent salary increases were in January 2003, when a law took effect establishing salaries for constitutional officers as a percentage of the governor's salary. Laws 2001, 1st spec. sess., ch. 10, art. 1, § 2. The most recent salary increase for the governor was 2.5 percent in January 1998.

The governor can veto legislation establishing compensation for constitutional officers because, according to the constitution, the compensation is set "by law."

Salaries for judges

The Minnesota Constitution stipulates that the legislature should establish compensation for judges and that judges' salaries cannot be reduced while they are in office. Art. VI, § 5. The most recent salary increases for judges were 3 percent, and took effect in July 2008 as required under a 2007 law. Laws 2007, ch. 54, art. 1, § 3. Annual salaries for various judges are as follows:

Official	Salary
Supreme Court, chief	$160,579
Supreme Court, justice	$145,981
Court of Appeals, chief	$144,429
Court of Appeals, justice	$137,552
District Court, chief	$135,580
District Court, judge	$129,124

The constitutional provisions governing judges have been interpreted to mean that the governor may not veto provisions setting judges' compensation because their compensation is prescribed "by the legislature." *Gardner v. Holm*, 241 Minn. 125, 62 N.W. 2d 52 (1954).

Salaries for legislators

The Minnesota Constitution provides that legislators' compensation is set by law. The annual salary for representatives and senators is $31,140. The House and the Senate each can designate three leadership positions to receive up to 140 percent of the compensation of other members of the legislature (this is an additional $12,456 per year).

The most recent salary increase for legislators was 5 percent in January 1999. The constitution also says that "no increase of compensation shall take effect during the period for which the members of the existing House of Representatives may have been elected." Art. IV, § 9. Because the constitution says that legislators' salaries are set "by law," the governor can veto legislation setting legislators' compensation.

The compensation council's role in establishing salaries

The legislature has established a 16-member compensation council to assist it in establishing the compensation of constitutional officers, judges, and legislators. Minn. Stat. § 15A.082. A new compensation council is created in the fall of each even-numbered year; the new council must make its recommendations to the legislature by May 1 of the odd-numbered year.

By law, the council's recommendations take effect if an appropriation to pay the recommended salaries is enacted after the recommendations are submitted and before their effective date. As a practical matter, when the legislature has increased salaries, it generally has done so either by expressly adopting or modifying compensation council recommendations or by establishing percentages in law without reference to compensation council recommendations.

Insurance benefits and pension plans

Constitutional officers, legislators, and judges all are members of the state employee group insurance plan and receive the same insurance benefits as state employees.

Most legislators (all who were first elected after July 1, 1997, and some elected before then) and all constitutional officers are members of a defined contribution pension plan. Under this plan, the member contributes 5 percent of his or her salary and the state contributes 6 percent. This money is invested, and upon leaving state service, the elected official is eligible to receive whatever money is in the account.

Judges belong to a defined benefit pension plan, in which the benefit is determined by multiplying years of service times a service-credit percentage and applying this percentage to the judge's average high-five years of salary.

For more information: Contact legislative analyst Mark Shepard at 651-296-5051. For historical information on elected officials' salaries, see the Legislative Coordinating Commission's website: www.commissions.leg.state.mn.us/lcer/officialssalaries.htm.

Joel Michael **Updated: October 2011**

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., most partnerships and Limited Liability Companies, "S" corporations, and other entities that do not pay entity level taxes); the owners of these entities (shareholders, partners, or LLC members) 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 exempt from the federal income tax

Tax base is profits

The tax base is taxable income, 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 a partial exemption for some types of foreign source income and for certain 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 U.S. Constitution, a state can legally tax only the income of a business that is "fairly apportioned" to its 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 (90 percent weight), property (5 percent), and payroll (5 percent). (These weights are for tax year 2011. 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
- Historic structure rehabilitation credit
- Jobs credit under the JOBZ program

Revenues go to the general fund

Fiscal year 2010 actual revenues were $664 million or about 5 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 2011 that corporate franchise tax collections will be $990 million in fiscal year 2011 and $772 million in fiscal year 2012.

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 can drop quite precipitously. For example, in fiscal year 2006 (an expansion year) the state collected $1,062 million in corporate franchise tax. In fiscal year 2009 (a recession year), corporate franchise tax revenues dropped to $659 million or 38 percent less than 2006.

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), partnerships, and LLCs must pay a minimum fee based on the sum of their Minnesota property, payroll, and sales. This fee is an "add-on" fee that is 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. In 2011, Governor Dayton proposed increasing and indexing the amounts for inflation, but these changes were not enacted into law.

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 joel.michael@house.mn. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax*, October 2011, and *Apportionment of Corporate Franchise Tax*, October 2011.

Joel Michael

Updated: October 2011

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 2011 weights sales at 90 percent, property at 5 percent, and payroll at 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:

$$MN\ percent = \left(0.9 * \frac{MnSales}{TotalSales}\right) + \left(0.05 * \frac{MnProperty}{TotalProperty}\right) + \left(0.05 * \frac{MnPayroll}{TotalPayroll}\right)$$

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 joel.michael@house.mn. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax,* October 2011, and *Corporate Franchise Taxation*, October 2011.

Joel Michael

Updated: October 2011

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 to another entity in a unitary business, 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).

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?

In 2011, the Department of Revenue estimated that repeal of the FOC and foreign royalty provisions would increase tax revenues by about $117 million for fiscal year 2013. By comparison, total corporate tax revenues are estimated to be $1.1 billion for fiscal year 2013. Thus, the provisions reduce revenues by about 10 percent. Put another way, repeal would allow the tax rate to be reduced from 9.8 percent to less than 9 percent without reducing state revenues.

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 other domestic corporations 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 by satisfying 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 and their factors 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, because the FOC definition then considered only the location of tangible property and employees.) 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. The charges for use of these intangibles were typically paid by other members of the unitary group, which 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 can also affect Minnesota tax liability.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn.

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: October 2011

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 corporate 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. The table shows the phase-in schedule for the transition to single sales apportionment from 2011 to 2014.

Tax year	Sales	Property	Payroll
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. One 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 the desired effects on competitiveness. Tax theorists argue that if the corporate tax is to be a benefits tax (i.e., based on businesses' 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

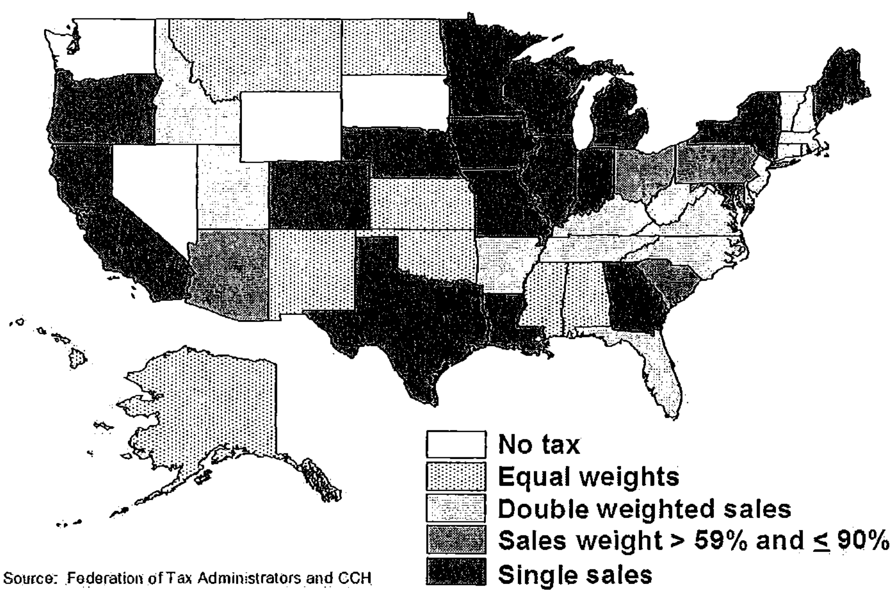
Compared with equally weighting each of the apportionment factors, weighting sales more heavily reduces Minnesota tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2010) shows an expenditure cost of $153 million for fiscal year 2011, rising to $214 million in 2013.

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 2011, 16 states use or allow single sales as their apportionment formula for manufacturers. This is up from 14 states for tax year 2010. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Indiana, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. South Carolina and New Jersey are scheduled to use single sales in 2013, Virginia (in addition to Minnesota) in 2014, and Arizona in 2017. The map below shows the apportionment formulas for manufacturers as of tax year 2011. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.

Apportionment of Corporate Income

Applicable to Manufacturers



Source: Federation of Tax Administrators and CCH

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, October 2011.

Joel Michael

Updated: October 2011

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 tangible property (typically real estate) 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. 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 (the rate of tax on increases in estate value) of up to 41 percent. Average or effective rates can never exceed 16 percent, though.

The 2011 Legislature enacted an exclusion for qualifying small business property and farmland

2011 legislation provided two special exclusions for qualifying small business property and homestead farmland, effective for decedents dying after June 30, 2011. The combined value of these exclusions cannot exceed $4 million, allowing a total exemption of $5 million when they are added to the basic $1 million exemption. The decedent or spouse must have owned the qualifying property for three years before the date of death and the heirs must continue to own and use the property in the trade or business for three years after the date of death. Failure to do so triggers a recapture tax equal to 16 percent of the value of the property.

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

Revenues from the tax are deposited in the general fund. The Department of Management and Budget (February 2011 forecast) estimates that the tax raises about $160 million to $185 million per fiscal year. *See the box to the right for the last five years of 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 2006-2010 (millions)

2006	$215.9
2007	$110.9
2008	$121.3
2009	$135.9
2010	$151.8

Source: Minnesota Management & Budget

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 change 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, the 2001 repeal of the credit made the state tax a "real" tax that reduces the amount of 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. Most states have taken no action to impose estate taxes or have repealed their taxes. Several states—Alabama, California, Florida, and Nevada—are constitutionally prohibited from imposing estate or inheritance taxes. Several states without estate or inheritance taxes also have no income tax (for example, Florida, Nevada, South Dakota, and Texas), allowing individuals who change their domiciles to these states to avoid both taxes.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research information brief *Survey of State Estate, Inheritance, and Gift Taxes,* September 2010.

Joel Michael **Updated: October 2011**

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 taxes and fees are set on a per-unit basis, they do not increase as the prices of cigarettes increase. (The tax in lieu of the general sales tax on cigarettes is annually indexed for inflation in the price of cigarettes so it increases with overall increases in cigarette prices.) 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. Thus, these taxes fluctuate as the prices of the products change.

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 effective August 1, 2010 through December 31, 2011)	34.6 cents	NA

A per-pack tax applies in lieu of the state general sales tax

Since 2005, cigarette sales have been exempt from state and local general sales taxes. A per-pack tax applies instead of the sales tax. The commissioner of revenue annually sets this in-lieu tax based on a survey of retail prices of cigarettes in the state. The rate is set as an average of these prices and is reset each August 1 (starting in 2012, it will be reset each January 1). The in lieu tax does not replace local sales taxes, although cigarette sales are exempt from these local taxes.

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 or that have not entered the Master Settlement Agreement as participating manufacturers.

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. Michigan and Utah also impose a 35-cent surcharge on these cigarettes.

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. The United States Supreme Court in both instances declined to hear the cases. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) *cert. denied* 549 U.S. 1052 (2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) *cert. denied* 549 U.S. 1206 (2007) (health impact fee).

The taxes and fees are estimated to yield revenues of over $424 million in FY 2012

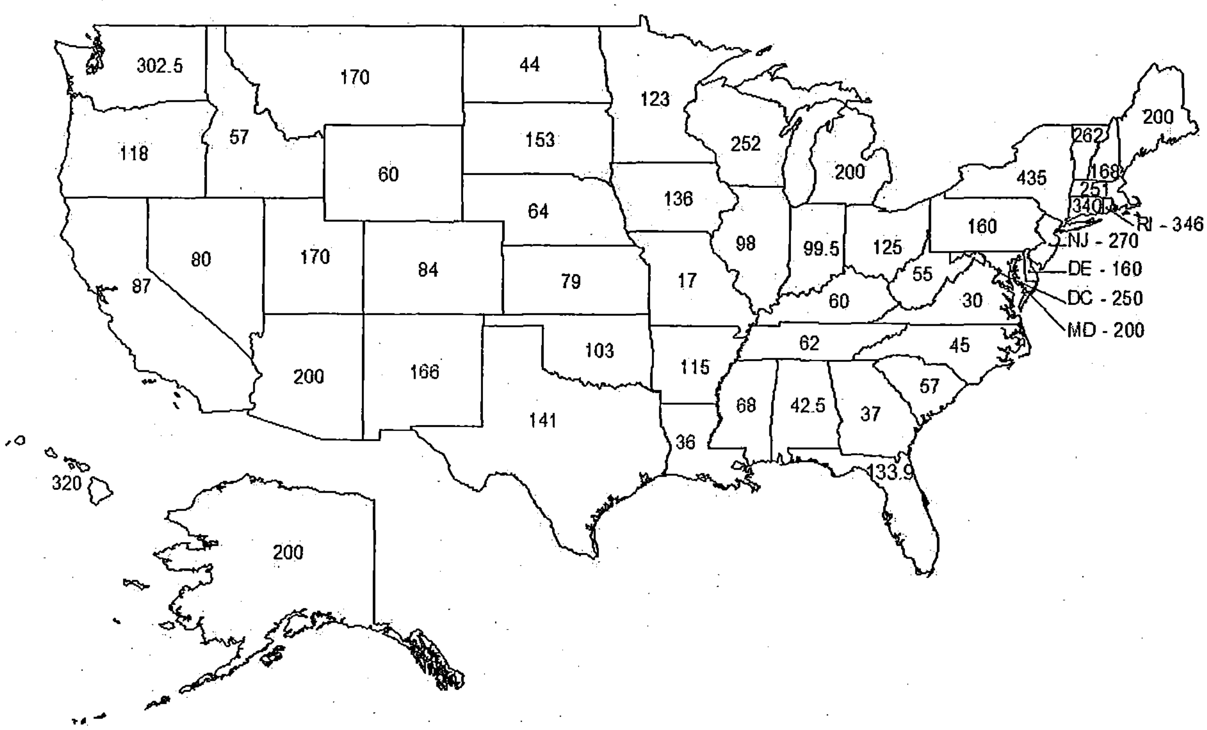
For fiscal year 2012, Minnesota Management and Budget estimates collections from the two excise taxes and the sales tax on cigarettes will be $221.8 million and from the health impact fee, $202.5 million (February 2011 forecast). Revenues from the tobacco products tax are deposited in the general fund. Each fiscal year, cigarette tax revenues of $22.25 million go to fund the Academic Health Center, $3,937,000 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 ($2.52), South Dakota ($1.53), and Iowa ($1.36). North Dakota (44 cents) has a lower rate. All states' rates are shown on the map below. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $1.50 in New York City and $2.68 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.

State Cigarette Tax Rates*

as of 7/1/2011
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 joel.michael@house.mn.

HOUSE RESEARCH | Short Subjects

Joel Michael
Updated: October 2011

Mortgage and Deed Taxes: An Overview

What are the mortgage registry and deed taxes?

The mortgage registry tax (MRT) and deed taxes are two separate state taxes that apply to many real estate transactions. The MRT is based on the amount of debt secured by a mortgage of real property and is imposed when the mortgage is recorded. 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 together, since many property transactions trigger both taxes.

What are the rates?

The MRT rate is 0.23 percent of the total debt. The deed tax rate is 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 illustrates how each tax applies to a typical home purchase.

Mortgage Registry Tax

John and Mary Anderson buy a home with a purchase price of $150,000. The Andersons make a $20,000 down payment and take out a home loan with a principal amount of $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?

The mortgagor (borrower) is liable for the MRT, while the seller is liable for the deed tax. As a practical matter, the lender usually collects both of the taxes at closing and remits them to the county when the mortgage and deed are recorded.

The deed tax is collected from the seller at closing. But since the deed tax must be paid to record a deed and since it is primarily in the buyer's interest to record the deed, the tax may fall on the buyer if the seller fails to pay the tax.

Who collects the money?

County treasurers collect these taxes. They remit 97 percent of the revenues to the state for deposit in the state general fund. The county retains the other 3 percent for its administrative expenses.

How much is collected?

The table below shows the MRT and deed tax collected by the state for the past 12 years. The amounts reflect only the state's 97 percent share.

Collections are sensitive to the volume and value of real estate transactions; MRT collections are also sensitive to refinancing activity. The effects of the 2007-2009 recession and the resulting decline in real estate values and transactions are apparent; 2011 collections from the two taxes were less than half the 2006 level.

State MRT and Deed Tax Revenue (in millions)

Fiscal Year	Mortgage	Deed	Total	Change (from previous year)	Pct change (from previous year)
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	149.6	111.5	261.1	-48.9	-15.8%
2008	114.4	84.3	198.7	-62.5	-23.9%
2009	101.2	59.7	160.9	-37.8	-19.0%
2010	94.6	58.5	153.1	-7.8	-4.8%
2011	N/A	N/A	141.3	-11.8	-7.7%

* Accelerating the June payment began in fiscal year 2004 and distorts the change amounts and percentages for fiscal years 2004 and 2005.

Source: 2000–2010, Department of Revenue; 2011, Minnesota Management & Budget, July/August 2011 Economic Update

Are there exemptions from the taxes?

Both taxes have multiple exemptions. MRT exemptions include contracts for deed, certain agricultural mortgages, marriage dissolution decrees, and certain low- and moderate-income housing mortgages. Common deed tax exemptions are mortgages, plats, wills and testamentary distributions, leases, sheriff's foreclosure sale certificates, and marriage dissolution decrees.

Can local governments also impose mortgage and deed taxes?

State law authorizes Ramsey and Hennepin county to impose local mortgage and deed taxes. Both of these county taxes have rates of 0.0001 (or 0.01%) for both taxes. The taxes expire on January 1, 2013, unless the 2012 Legislature extends the authority to impose the taxes. Bills have been introduced (and have passed one or both houses) to authorize Anoka, Dakota, and St. Louis counties to also impose local mortgage and deed taxes. These proposals have not been enacted into law.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publication *Mortgage and Deed Taxes in Minnesota*, April 2002.

Joel Michael and Nina Manzi **Updated: October 2011**

Revenue Recapture Program

Revenue recapture allows state and some local governments to collect debts by intercepting tax refunds

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.

The following agencies may use the Revenue Recapture Program:

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

A variety of debts qualify for collection using 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 $11,400 and $21,550 in 2010, depending upon family size) to repay debts for medical care, including hospitalization, 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
- Sustainable forest incentive 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 hearing, which the claimant agency initiates; the hearing is conducted as a contested case under the Administrative Procedures Act.

Child support has first priority for collection

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.

A $15 administrative fee applies

A fee of $15 per claim is first deducted from the refund, and the claimant agency receives the balance of the refund or the claim amount, whichever is less. 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 $78 million was recaptured in 2010

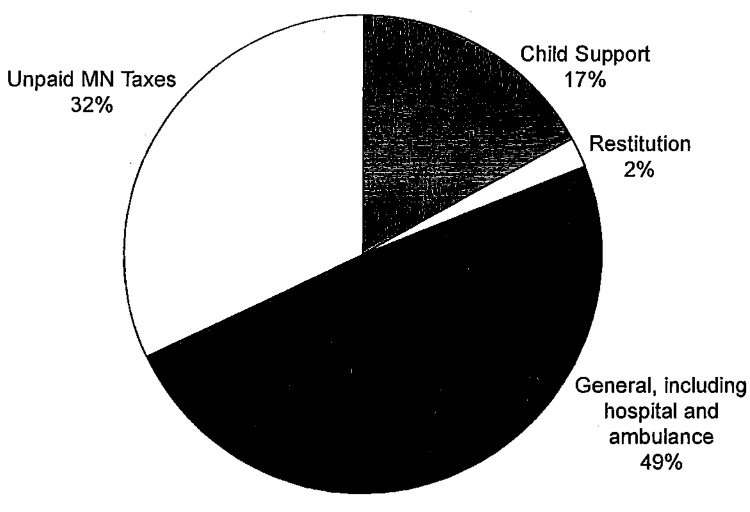
The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2006 to 2010.

The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2006 to 2010 by four of the major types of debts for which the law sets priorities.

Revenue Recapture Amounts CY2006-2010

	Number of Offsets	Amount of Recapture
2006	179,754	$59,945,770
2007	211,636	$68,275,418
2008	230,911	$87,756,822
2009	216,623	$72,845,049
2010	226,754	$78,173,924

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/pages/rr_index.aspx for more information for claimant agencies; call 651-556-4758; or email mdor.recapture@state.mn.us.

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: October 2011

TIF Redevelopment Districts

How does TIF 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 2011 Tax Increment Financing Report of the State Auditor, there were more active TIF redevelopment districts (941) than any other type, about 48 percent of all TIF districts (1,979) in 2009.

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 declared a disaster area 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 preexisting 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 joel.michael@house.mn. Also see the House Research short subject *Tax Increment Financing*, October 2010.

Joel Michael

Updated: October 2011

MinnesotaCare Provider Taxes

What are the taxes?

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

Who is subject to the tax?

Provider taxes apply to the following:

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

What entities are exempt from the tax?

MinnesotaCare provider taxes do not apply to the following:

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

What is the tax base?

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

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

What is the tax rate?

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

What exemptions apply?

Exemptions from the tax apply to the following payments:

- For services provided under Medicare
- For home health care services
- Those made from the state chemical dependency fund
- Those funded by charitable donations not designated for an individual or group
- Those under programs funding research on human subjects in compliance with federal law
- Those made by the federal employee and military (Tricare) health insurance plans that cover federal workers and military personnel and retirees
- Those from providers that were already subject to the tax

Are credits allowed?

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

How is the tax paid?

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

How are drugs taxed?

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

How much revenue is collected from the taxes?

In February 2011, the Department of Management and Budget estimated that the MinnesotaCare provider taxes will yield $512.1 million in revenues for the health care access fund in fiscal year 2012. Because health costs are rising at a rapid rate and because consumption of health services is also increasing steadily, these revenues are likely to rise at a faster rate than most other state tax sources.

Are these the only sources of revenue for the health care access fund?

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

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn.

HOUSE RESEARCH | Short Subjects

Randall Chun Revised: October 2011

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). Federal Medicaid law 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, persons with disabilities, and adults without children.
- 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
Adults without children	75	None

* 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. There is no spenddown for adults without children.

- Be a U.S. citizen or a noncitizen who meets specified immigration criteria.
- Be a resident of Minnesota.
- Meet other program eligibility requirements.

Medicaid Expansion

The federal Affordable Care Act (ACA) requires states, effective January 1, 2014, to expand Medicaid to adults without dependent children with incomes not exceeding 133 percent of FPG who meet specified criteria. The ACA allows states to expand or phase in coverage to this group before this date. The 2010 Legislature gave the current governor and the succeeding governor the option to implement by executive order early Medicaid expansion for adults without dependent children with incomes not exceeding 75 percent of FPG. Gov. Mark Dayton issued an executive order that implemented early expansion effective March 1, 2011.

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 developmental disabilities (ICF/DD) 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/DD.

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, county-based purchasing initiatives, and programs for the elderly and persons with disabilities).

Funding and expenditures

In fiscal year 2010, total state and federal MA expenditures for services were $7.236 billion. The federal share of MA costs is determined by a formula based on state per capita income. In most recent fiscal years, the federal government has paid 50 percent of the cost of MA services, with Minnesota responsible for the remaining 50 percent. For the period October 1, 2008, through June 30, 2011, federal law provided Minnesota (and other states) with an enhanced federal match.

Recipients

During fiscal year 2010, an average of 608,651 individuals were eligible for MA services each month. As of July 2011, 466,221 MA recipients received services under PMAP, a county-based purchasing initiative, or managed care programs for the elderly or persons with disabilities.

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*, October 2011.

HOUSE RESEARCH | Short Subjects

Nina Manzi Updated: October 2011

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 additions and subtractions.

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 2012. These items are subject to Minnesota tax, but not federal tax.

- **State income tax deduction.** Filers who claimed a federal itemized deduction for state income taxes paid must add that amount to 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.**
- **Expenses relating to income not taxed by Minnesota.**
- **Capital gain part of lump-sum distributions from qualified retirement plans.**
- **Fines and penalties allowed as deductions from federal taxable income.**
- **80 percent of the difference between federal and state allowances for bonus depreciation and section 179 expensing.**
- **Net operating losses allowed at the federal level under a different schedule than at the state level.**
- **The additional standard deduction amount allowed to married filers** under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA).
- **The amount of itemized deductions subject to limitation and personal and dependent exemptions subject to phaseout** under federal law prior to enactment of TRUIRJCA.

What subtractions does Minnesota allow from taxable income?

Minnesota allows the following *subtractions* from federal taxable income for tax year 2012. The estimated reductions in revenue shown below are taken from the Department of Revenue's *Tax Expenditure Budget for 2010-2013.* Revenue estimates made during the 2012 legislative session will differ because they will be based on a more recent economic forecast.

- **State income tax refund.** The federal income tax allows an itemized deduction for state income taxes. Minnesota requires itemizers 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** ($14.8 million in fiscal year 2013). 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** ($4.9 million in fiscal year 2013).
- **Compensation for most military service in Minnesota** ($3.8 million in fiscal year 2013). 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** ($6.4 million in fiscal year 2013). 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** ($0.4 million in fiscal year 2013). 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** ($7.8 million in fiscal year 2013). 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 2013). 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 2013). 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** ($100,000 in fiscal year 2013). Allowed for taxes paid to a foreign governmental unit, to the extent the taxpayer did not claim the federal foreign tax credit for the subnational taxes (estimate prepared by Department of Revenue in 2009 session).
- **National service education awards** ($100,000 in fiscal year 2013). Allowed for scholarships received for AmeriCorps service.
- **Bonus depreciation, section 179 expensing, income from the discharge of indebtedness, and net operating losses.** Allowed for amounts included in Minnesota taxable income, but not federal taxable income, in earlier tax years.

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*, August 2011; and *Minnesota's Elderly Exclusion* (web only) on the income tax page of the House Research web site: www.house.mn/hrd/hrd.htm.

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

Jim Cleary

October 2011

Concurrent Receipt of Military Retirement Pay and Veterans Disability Compensation

Veterans may be eligible for military retirement pay, and if they are disabled, they may also be eligible for veterans disability compensation. Federal law governs both military retirement pay and veterans disability compensation, and determines the situations in which veterans can receive both. While only a small percentage of veterans are military retirees, many military retirees have incurred one or more service-connected disabilities and are affected by concurrent receipt policies. These issues are governed by federal law and are not under the jurisdiction of the states. This short subject briefly explains each type of compensation and the situations in which a veteran may be eligible to receive both.

Veterans may be eligible for military retirement pay and veterans disability compensation

A military retiree (generally, a service member who serves 20 years or more in the military) typically qualifies for military retirement pay and certain other veterans benefits. The amount of military retirement pay due a military retiree is based on a formula or scale that factors in the person's military rank at retirement and the person's length of military service. Military retirement pay is determined and paid by the U.S. Defense Finance and Accounting Service (DFAS).

A disabled veteran may apply for disability compensation from the U.S. Department of Veterans Affairs (VA). The VA can approve veterans as eligible for veterans disability compensation for one or more documented service-connected injuries or illnesses that continue to affect the person's health or abilities following separation from the military. The VA pays this compensation, with the monthly amount based on a formula or scale that factors in the person's military rank and the person's service-connected disability rating. Service-connected disability ratings are made in 10 percent increments from 0 percent to 100 percent, with a special category for disabilities rated as 100 percent total and permanent. (Disabilities not related to military service are not considered.)

In most cases, veterans cannot receive both retirement benefits and disability compensation

"Concurrent receipt" refers to a veteran's eligibility to receive both military retirement benefits and VA disability compensation. Until 2004, concurrent receipt was prohibited by federal law, so a person receiving military retirement pay was required to waive some or all of that pay in order to receive VA disability compensation. The federal law was changed as of January 1, 2004, so that any military retiree with a VA disability rating of 50 percent or higher, or any Purple Heart medal recipient with a rating of 10 percent or higher, is eligible for full concurrent receipt of his or her military retirement pay and veterans disability compensation.

However, the waiver is still the law for most military retirees with a VA service-connected disability rating of less than 50 percent. This waiver of retirement pay for disability compensation causes a dollar-for-dollar offset. As a result, a military retiree subject to the federal ban on concurrent receipt is limited to the higher of: (1) the person's military retirement pay; or (2) the person's veterans disability compensation, but not to the sum of the two.

The principal advantage of the waiver for the veteran is to substitute veterans disability pay, which is exempt from all taxation, for military retirement pay, which is subject to taxation.

Congress expanded eligibility for concurrent retirement and disability pay

Congress has continued to expand eligibility for concurrent receipt of retirement pay and disability compensation (CRDP) to include additional populations of veterans. As of January 2011, the law allows concurrent receipt for the following groups:

- Military retirees who are 100 percent disabled with 20 years of service
- All combat-disabled military retirees regardless of length of service or percentage of disability as described below
- Disabled military retirees with 20 years of service who are deemed "unemployable" by the VA
- Chapter 61 retirees with 20 years of service, who have suffered combat or operations-related injuries, with partial benefits if under 20 years service (Chapter 61 retirees are people forced to retire from the military because of medical issues; see 10 U.S.C. §§ 1201-1222.)

An estimated 300,000 disabled military retirees nationally currently qualify for concurrent receipt. This represents about 30 percent of the military disabled retired population.

Some retirees can receive compensation to replace a disability offset

Combat-related special compensation (CRSC) is authorized in federal law and provides military retirees monthly compensation to replace a VA disability offset. Under this law, all qualified military retirees with 20 or more years of service with a "combat-related" VA-rated disability are exempt from any ban on concurrent receipt and are eligible to receive both full military retirement pay and VA disability compensation.

A portion of Minnesota veterans are military retirees

Minnesota has approximately 400,000 veterans; about 60,000 of them have a VA disability rating, but only about 15,000 are military retirees (including both active duty and National Guard and other Reserve retirees). Many of these 15,000 military retirees are likely to have service-connected disabilities, as determined by the VA.

Because these policies are governed by federal law, Minnesota has no jurisdiction or authority to change them.

For more information: Contact legislative analyst Jim Cleary at jim.cleary@house.mn.

HOUSE RESEARCH | Short Subjects

Randall Chun

Revised: October 2011

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.

Note: *The following text describes program changes that have been approved by the federal government but for which implementation by DHS is pending.*

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 ($61,488 for a household of four), and 250 percent of FPG for adults without children ($27,228 for a household of one and $36,780 for a household of two). Parents with annual gross incomes over $57,500 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 200 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 200 percent of FPG and certain other children are exempt from this requirement if they are considered to be "underinsured."
- Be a resident of Minnesota. Enrollees must meet the residency requirements of the Medical Assistance (MA) program.

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 215 percent of FPG and all adults without children are subject to an annual inpatient hospital benefit limit of $10,000. Services not covered include personal care attendant services, private duty nursing, nursing home care, ICF/DD (intermediate care facility for persons with developmental disabilities), and special transportation services.

Premiums and cost-sharing

Enrollees must pay premiums based on a sliding scale. Children with incomes that do not exceed 200 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

Nearly 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.

Defined contribution program

Effective July 1, 2012, adults without children with incomes greater than or equal to 200 percent of FPG but not exceeding 250 percent of FPG will use monthly defined contributions provided by the state to purchase private sector health coverage. Covered services and cost-sharing will be as provided under the terms of the private sector policy. Defined contribution enrollees will not pay MinnesotaCare premiums, but will be required to pay any portion of the premium for private sector coverage that exceeds the monthly defined contribution.

Funding and expenditures

In fiscal year 2010, the MinnesotaCare program paid $665 million for medical services provided to enrollees. Sixty-seven percent of this cost was paid for by the state, 28 percent by the federal government, and 5 percent by enrollees through premium payments (this last category also includes enrollee cost-sharing).

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, and for enrollees who are adults without children with incomes greater than 75 percent but not exceeding 250 percent of FPG. The state receives federal funding at an enhanced match rate (under the Children's Health Insurance Program) for children under age 21 with incomes equal to or greater than 133 percent, but not exceeding 275 percent of FPG.

Recipients

As of June 2011, 142,958 individuals were enrolled in the MinnesotaCare program. Just over six out of ten 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*, October 2011.

HOUSE RESEARCH | Short Subjects

Jim Cleary & Janelle Taylor

Updated: November 2011

Firearms Transportation in Motor Vehicles

What is the history of Minnesota's laws regarding the transportation of firearms in motor vehicles?

Since 1986, Minnesota has had a law prohibiting a person from transporting a firearm in a motor vehicle unless the firearm is unloaded and fully secured in a gun case expressly made for that purpose, or is unloaded and in the closed trunk of a motor vehicle. (Minn. Stat. § 97B.045)

The law provides an exception for a handgun being carried under the terms of a valid permit to carry (i.e., in accordance with Minnesota Statutes section 624.714). When being transported by a person with a valid permit to carry, a handgun may be cased or uncased, loaded or unloaded, and concealed or openly carried.

In 2009, the law was amended to allow an uncased, unloaded rifle or shotgun to be transported in a motor vehicle in the following situations:

- while at a shooting range, as defined under Minnesota Statutes, section 87A.01, subdivision 3, where the person has received permission from the lawful owner or possessor to discharge firearms
- while lawfully hunting on private or public land, including possessing a valid hunting license (if required)
- while traveling to or from a site where the person intends to hunt lawfully that day or has hunted lawfully that day

The rifle or shotgun, whether cased or uncased, must still remain unloaded while being transported in a motor vehicle. (Laws 2009, ch. 176, art. 2, § 40) (The original 2009 law had an exception that also required a rifle or shotgun to remain cased within an area where the discharge of a firearm has been prohibited by ordinance. In 2011 the law was amended to remove that requirement. (Laws 2011, 1st spec. sess., ch. 2, art. 5, § 41.))

A rifle or shotgun must remain cased while being transported in a motor vehicle:

- within Anoka, Hennepin, and Ramsey counties;
- within the boundary of a city with a population of 2,500 or more;
- on school grounds; and
- as regulated under statutes governing game refuges, shining of artificial lights, and use of night vision devices.

Are there any other exemptions to the law?

None of the restrictions in Minnesota Statutes, section 97B.045, regarding the transportation of firearms, apply to a disabled person if:

- the person possesses a permit for disabled hunters issued under Minnesota Statutes, section 97B.055, subdivision 3; and
- the firearm is not loaded in the chamber until the vehicle is stationary, or is a hinge-action firearm with the action open until the vehicle is stationary.

The 2009 law also repealed a third condition that required the disabled person to be participating in a hunt sponsored by a nonprofit or to be hunting on land owned or leased by the disabled person. (Laws 2009, ch. 176, art. 2, § 39)

What is the penalty for violating the law? It remains a misdemeanor crime to violate Minnesota's firearms transportation law. The crime is punishable by up to 90 days in jail and a $1,000 fine.

Does the law affect a person with a permit to carry? No. A person with a valid permit to carry a pistol issued in accordance with the Minnesota Personal Protection Act of 2003 (Minn. Stat. § 624.714) can still transport a pistol in a motor vehicle (whether as a driver or a passenger), irrespective of whether it is cased or uncased, is loaded or unloaded, or is concealed or being carried openly.

Does the law affect who may possess a firearm? No. A person's status under federal and Minnesota law as a firearms-prohibited person is not affected by the new or the previous firearms transportation law. A firearms-prohibited person continues to be prohibited from possessing any firearm in any manner, including for the purpose of transporting it.

How are the terms of the game and fish laws defined for the firearms transportation law? For purposes of Minnesota Statutes, section 97B.045, and other game and fish laws, certain key terms are defined as follows:

- "Motor vehicle" means a self-propelled vehicle or a vehicle propelled or drawn by a self-propelled vehicle that is operated on a highway, on a railroad track, on the ground, in the water, or in the air (Minn. Stat. § 97A.015, subd. 32)
- "Hunting" means "taking" birds or mammals. "Taking" is further defined as pursuing, shooting, killing, capturing, trapping, snaring, angling, spearing, or netting wild animals, or placing, setting, drawing, or using a net, trap, or other device to take wild animals. Taking includes attempting to take wild animals and assisting another person in taking wild animals. (Minn. Stat. § 97A.015, subds. 26 and 47)
- "Possession" means both actual and constructive possession and control of the things referred to. (Minn. Stat. § 97A.015, subd. 36)

For more information: Contact legislative analyst Jim Cleary at jim.cleary@house.mn or Janelle Taylor at janelle.taylor@house.mn.

Joel Michael **Updated: November 2011**

Estate and Inheritance Taxation: An Overview of Taxes in the States

This short subject summarizes the status of state inheritance and estate taxes in the states as of September 2011.

After Congress repealed the credit that allowed states to impose "pickup" estate taxes that were borne by the federal treasury, 28 states eliminated their taxes

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 Congress repealed the federal credit for state death taxes (effective for deaths after December 31, 2004). Now that they can no longer impose taxes that do not increase the total tax burden on estates and heirs, most states (28 for 2011 deaths) no longer impose estate or inheritance taxes. Minnesota has opted to continue imposing an estate tax equal to the credit under prior federal law.

The two types of taxes differ in the base for computing them; one depends on the total size of the estate, the other on to whom bequests are made

Estate taxes generally apply a single tax rate schedule to the taxable value of the decedent's total estate (bequests to charities and surviving spouses are typically exempt).

Inheritance taxes apply varying tax rate schedules to bequests made to different classes of beneficiaries. Bequests to surviving spouses and lineal heirs typically enjoy lower rates or are totally exempt, while bequests to more distant or unrelated heirs (collateral heirs) are usually taxed at higher rates or have lower exemptions or both.

Fourteen states and the District of Columbia impose only estate taxes

For decedents dying in calendar year 2011, 14 states (Connecticut, Delaware, Hawaii, Illinois, Maine, Massachusetts, Minnesota, New York, North Carolina, Ohio, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia impose only estate taxes. Two of these states (Delaware and Hawaii) had allowed their taxes to expire after Congress repealed the federal credit for state death taxes, but reenacted the taxes in 2010 in response to the reductions in revenue resulting from the recession of 2007-09. In 2011, Ohio repealed its estate tax, effective for decedents dying in 2013.

Exemption amounts under the state estate taxes vary. For 2011, they range from $5 million (North Carolina) to $338,333 (Ohio). The most common amount is $1 million (six states, including Minnesota). Top rates range from 7 percent to 19 percent with most states, like Minnesota, imposing a top rate of 16 percent.

Six states impose only inheritance taxes

Six states (Indiana, Iowa, Kentucky, Nebraska, Pennsylvania, and Tennessee) impose only inheritance taxes.

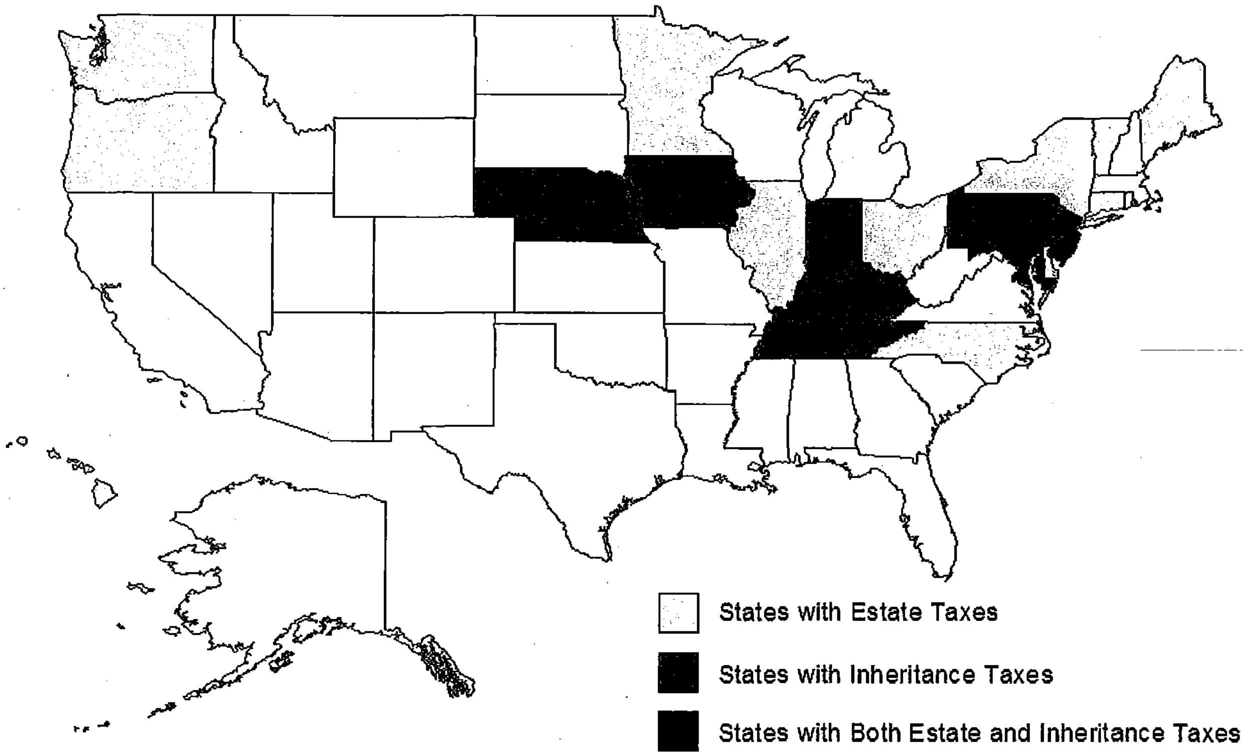
The exemptions under these taxes vary greatly, ranging from $100 (Indiana) for bequests to unrelated individuals, to unlimited exemptions (Iowa and Kentucky) for bequests to lineal heirs, such as children or parents of the decedent. (Most states do not tax bequests to surviving spouses under either estate or inheritance taxes.) Top tax rates range from 4.5 percent (Pennsylvania on lineal heirs) to 20 percent (Indiana on collateral heirs).

Two states impose both taxes

Maryland and New Jersey impose both types of taxes, but the estate tax paid is a credit against the inheritance tax, so the total tax liability is not the sum of the two, but the greater of the two taxes.

The map shows the states with estates and inheritance taxes.

State Estate and Inheritance Taxes



For more information: See the information brief *Survey of State Estate, Inheritance, and Gift Taxes*, November 2011.

Lisa Larson November 2011

Principal and Teacher Accountability Laws

The 2011 Legislature enacted laws that establish principal and teacher accountability. Principal accountability requirements apply beginning in the 2013-2014 school year, and teacher accountability requirements apply beginning in the 2014-2015 school year.

A superintendent must annually evaluate school principals using a performance-based system

The principal accountability laws require a superintendent to use a performance-based system to annually evaluate each school principal assigned to supervise a school building within the school district (Minn. Stat. § 123B.143, subd. 1; § 123B.147, subd. 3; Laws 2011, 1st Spec. Sess., ch. 11, art. 2, § 47). The evaluation is to improve teaching and learning by enhancing the principal's ability to shape the school's professional environment and support and improve school performance, student achievement, and teacher quality, performance, and effectiveness. The evaluation must satisfy eight criteria:

- Support and improve a principal's instructional leadership, organizational management, and professional development, and strengthen the principal's capacity in instruction, supervision, evaluation, and teacher development
- Include formative and summative assessments
- Be consistent with a principal's job description and the plans and goals of the district and the principal, and support leadership behaviors and practices, rigorous curriculum, school performance, and high-quality instruction
- Include on-the-job observations and previous evaluations
- Allow surveys to help identify a principal's effectiveness, leadership skills and processes, and strengths and weaknesses in exercising leadership
- Use longitudinal data on student academic growth that incorporate district achievement goals and targets
- Be linked to professional development that emphasizes improved teaching and learning, curriculum and instruction, student learning, and a collaborative professional culture
- Require an improvement plan for a principal not meeting standards of professional practice or other performance criteria and specify the procedures and consequences of failing to improve performance

These criteria are meant to be sufficiently flexible to accommodate district needs and goals for developing, supporting, and evaluating principals.

A group of experts must develop a model for principal evaluations

Before implementing annual principal evaluations, the education commissioner and the associations of secondary and elementary school principals first must convene a group of specified experts and stakeholders to develop a performance-based system model, which must be presented to the legislature by February 1, 2012. The group must consider how principals develop and maintain high standards for student performance, rigorous curriculum, quality instruction, a culture of learning and professional development, connections to external communities, systemic performance accountability, and leadership behaviors that create effective schools and improve school performance. The group also may consider whether to establish a multitiered evaluation system that supports newly licensed principals in becoming highly skilled school leaders and provides opportunities for advanced learning for more experienced school leaders.

Teachers will be evaluated under a locally agreed-upon process or a process developed by the education commissioner

The teacher accountability laws allow a school board and the exclusive representative of the teachers to jointly agree to an annual teacher evaluation and peer review process for probationary and nonprobationary teachers (Minn. Stat. § 122A.40, subds. 4, 5, 8, 9; and § 122A.41, subds. 2, 3, 5, 6). If there is no agreement, the district must implement the teacher evaluation and peer review process developed by the education commissioner and specified education stakeholders. Annual teacher evaluations are designed to develop, improve, and support qualified teachers and effective teaching practices and improve student learning and success. All annual teacher evaluations must satisfy 12 criteria:

- Provide the requisite evaluations for probationary teachers
- Establish a three-year professional review cycle for each teacher that includes a growth and development plan, peer review, the opportunity to participate in a professional learning community, and at least one summative evaluation performed by a qualified and trained evaluator
- Be based on professional teaching standards
- Coordinate staff development activities with the evaluation process and outcomes
- Perhaps allow school time for coaching and collaboration
- Perhaps include mentoring and induction programs
- Allow teachers to present a portfolio demonstrating evidence of reflection and professional growth that includes teachers' own performance assessment
- Use an agreed-upon teacher value-added assessment where value-added data are available and state or local student growth measures where value-added data are unavailable as a basis for 35 percent of teacher evaluation results
- Use longitudinal data on student engagement and connection and other student outcome measures aligned with curriculum for which teachers are responsible
- Require qualified and trained evaluators to perform summative evaluations
- Give teachers not meeting professional teaching standards the support to improve with established goals and timelines
- Discipline a teacher who does not adequately improve

Data on individual teachers generated under this evaluation process are defined as personnel data and are private data except as otherwise specified under law. The evaluations do not create additional due process rights for probationary teachers.

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

Joel Michael and Nina Manzi

Updated: November 2011

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 $300,000. Minnesota's limit is $235,000.

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 operating in 2001. TIAA-CREF, a large national financial institution, provides administration and investment management services for the plan. At the end of 2010, the Minnesota plan had over $819.8 million in assets and about 56,000 accounts or contracts. Nationally, total 529 plan assets were about $157 billion for about 10 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 September 2011, 32 states and the District of Columbia allowed tax deductions and three states (Indiana, Vermont, and Utah), credits for 529 plan contributions. (Only seven 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 four states provide deductions for contributions to any state plan. Most of the deductions and all three credits are subject to dollar caps, but four states do not limit the amount of their deductions.

Does Minnesota provide other incentives for participation?

Minnesota provided a matching grant program for contributions made through December 31, 2010. The 2011 Legislature repealed the matching grant program to reduce spending and balance the budget. Prior to its elimination, the matching grant program provided matches of up to $400 per year for families with annual incomes of $80,000 or less. The financial benefits of the match for qualifying families were roughly comparable to the benefits under most state tax deductions. However, few states impose income limits on the 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. Nine states provide matching grants and one operates a pilot grant program; most only provide grants to lower-income families. Like Minnesota, Michigan recently suspended funding for its matching grants, likely for budget reasons.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn 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.

Nina Manzi & Joel Michael **Updated: December 2011**

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 AMT requires taxpayers to pay tax under an "alternative" tax with a broader base and lower tax rates, if that results in higher tax liability than the regular tax.

What is the history of the AMT?

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. Minnesota first enacted an 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 three major differences.

- The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not.
- The Minnesota AMT has one flat rate, while the federal tax has two rates.
- The Minnesota AMT has a higher exemption amount than the federal AMT and the Minnesota exemption is indexed for inflation, while the federal exemption is not.

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 Minnesota's Regular Income Tax and AMT
($ amounts are for the 2012 tax year)

Feature	Regular Tax	AMT
Tax base	Federal adjusted gross income	Federal adjusted gross income
Rules carried over from federal AMT		Less generous depreciation rules Incentive stock options Depletion Intangible drilling costs Tax-exempt interest from private activity bonds
Standard deduction	$9,900 (married joint) $5,950 (single) $8,700 (head of household)	$69,230 for married joint (phased out for income from $150,000 to $426,920) $51,930 for single and head of household (phased out for income from $112,500 to $320,220)
Personal exemptions	$3,800 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	Credit for taxes paid to other states	Allowed
	Transit passes	Not Allowed
	Other nonrefundable credits (Long-term care insurance, marriage credit, past military service, health insurance premiums)	Allowed
	Refundable credits (working family, dependent care, K-12 education, combat zone service, bovine tuberculosis, angel investment, historic structure rehabilitation)	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 $27.6 million in tax year 2012, from about 15,800 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.

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

Nina Manzi

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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; and, through tax year 2011, $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 2009, the most recent year for which data is available, 60 percent of Minnesotans claimed the standard deduction and 40 percent itemized.

How much is the standard deduction?

In tax year 2012, the standard deduction is as follows:

- $11,900 for married couples filing joint returns
- $5,950 for married couples filing separate returns
- $8,700 for head of household filers
- $5,950 for single filers

What itemized deductions are allowed?

In tax year 2012, itemized deductions are allowed for the following:

- Payments of state and local property taxes and either income or sales 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 2012, the personal and dependent exemptions are $3,800 each. A family of four qualifies for four exemptions, totaling $15,200.

Are there limits on deductions and exemptions?

The federal Revenue Reconciliation Act of 1990 (RRA 1990) limited itemized deductions 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 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.

RRA 1990 also provided for personal and dependent exemptions to be phased out for taxpayers with incomes over a threshold. Affected taxpayers lose 2 percent of their total exemption amount for each $2,500 of income over the threshold.

The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually phased out the limitation on itemized deductions and the phaseout of exemptions over five years, from 2006 to 2010, so that in tax year 2010, the limitation and the phaseout were not in effect. The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the elimination of the deduction limitation and the exemption phaseout to tax years 2011 and 2012. In tax year 2013 the limitation of itemized deductions and the phaseout of exemptions will be reinstated.

The table shows the income thresholds for the itemized deduction limitation and the personal exemption phaseout in effect in tax year 2009. The income thresholds are adjusted annually for inflation, and the inflation adjustment will resume in 2013 if the limitation and phaseout are reinstated.

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

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,* August 2011.

HOUSE RESEARCH | Short Subjects

Nina Manzi and Lisa Larson

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The K-12 Education Deduction and Credit: An Overview

What is the K-12 deduction?

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

In tax year 2009 (fiscal year 2010) an estimated 176,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will cost the state $14.8 million in tax year 2012 (fiscal year 2013).

What expenses qualify for the deduction?

Qualifying expenses include the following:

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

What is the tax benefit of the deduction?

A deduction reduces an individual's taxable income. The tax benefit depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has three marginal tax rates: 5.35 percent, 7.05 percent, and 7.85 percent. A taxpayer in the 5.35 percent bracket who claims a $2,500 deduction will pay $133.75 less in state income taxes (5.35% x $2,500). A taxpayer in the 7.85 percent bracket with the same deduction will pay $196.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2012, a typical married couple with two dependents would need to have $24,850 of gross income before owing any state income tax.

What is the K-12 education credit?

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

In tax year 2009, 55,958 Minnesotans claimed a total of $14.7 million in K-12 education credits. The average credit was $262. In tax year 2012 (fiscal year 2013), the Department of Revenue estimates that Minnesota will claim $12.8 million in K-12 education credits.

What expenses qualify for the credit?

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

What is the tax effect of the credit?

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

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

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

How do taxpayers claim the deduction and credit?

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

Have the deduction and credit been challenged in court?

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

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

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

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

To date, nine states in addition to Minnesota provide income tax benefits for education-related expenses. **Arizona, Florida, Georgia, Indiana, Iowa, Pennsylvania,** and **Rhode Island** all provide tax credits for contributions to nonprofit school tuition organizations that operate like charities; Puerto Rico also allows a similar credit. **Pennsylvania** and **Rhode Island** allow their credits for corporate taxpayers; the **Florida** credit is allowed against corporate, insurance premiums, severance, alcoholic beverage taxes, and sales taxes for certain taxpayers; and **Arizona, Georgia, Indiana,** and **Iowa** have credits for both individual and corporate taxpayers. **Arizona** also allows credits for individuals who pay extracurricular public school fees and who contribute to character education programs at public schools, and **Pennsylvania** also allows a corporate credit for contributions to innovative public school programs. **Illinois** and **Iowa** both provide individuals with a nonrefundable tax credit for qualified education expenses, while **Louisiana** allows a tax deduction. Iowa's credit applies to tuition for children attending accredited not-for-profit K-12 schools, and Louisiana's deduction applies to public, private, and homeschool expenses. Courts in Arizona, Illinois, and Iowa have upheld the permissibility of these education credits.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Lisa Larson at 651-296-8036. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2011.

HOUSE RESEARCH | Short Subjects

Nina Manzi & Joel Michael Updated: December 2011

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 3 percent for 2010 through 2012.

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?

In certain circumstances, failing to file and underreporting tax liability are criminal offenses. 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

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The Federal Child Tax Credit

What is the federal child tax credit?

Parents may claim a credit against federal income tax for each child under age 17. The credit was enacted in the Tax Relief Act of 1997 (TRA) and first allowed in 1998. It was expanded under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and later laws. It equaled $400 per child in 1998, increased to $500 in 1999, $600 in 2001 and 2002, and $1,000 for 2003 through 2012. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) extended the $1,000 per-child amount through 2012. Unless extended by Congress, the credit will decrease to $500 per child in 2013 and following years.

Are there income limitations?

The credit is reduced by $50 for every $1,000 of income over $110,000 of adjusted gross income for married joint filers and $75,000 for head of household filers. A married couple filing jointly with two children under age 17 will become ineligible for the credit when their income reaches $150,000; a single parent claiming the credit for one child will become ineligible when income reaches $95,000.

Is the credit refundable?

The child credit is partly refundable; the refundable portion is referred to as the "additional child tax credit." In tax years 2009 through 2012, the additional child tax credit equals the greater of:

- 15 percent of earned income over $3,000, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

For example, a married couple with two children under age 17 and $30,000 of income is eligible for $2,000 in child tax credits, $1,000 for each child. If the couple claims the standard deduction, their federal income tax will equal $290 in 2012. They use $290 of their $2,000 credit to reduce their liability to $0. They may claim up to 15 percent of their earnings in excess of $3,000 as a refund. Assuming all $30,000 of their income is from wages, that means they would be eligible to claim up to $4,050 of the remaining credit as a refund (15 percent of $30,000 minus $3,000 equals $4,050). The result is that they claim $290 as an offset to their tax liability and are paid the remaining $1,710 as a refund.

When first enacted in TRA, the child credit was only refundable for taxpayers with three or more children, and only to the extent that their payroll taxes exceeded the federal earned income tax credit. The implicit rationale was that the refundable portion of the federal earned income tax credit was first used to offset payroll taxes for Social Security and Medicare, and then any payroll taxes left over after the federal earned income tax credit could be offset by the federal child credit. This refund mechanism was limited to families with three or more children because families with fewer children and no federal tax liability would typically have all of their payroll taxes offset by the federal earned income tax credit and none left over to be offset by the new child credit.

In 2001 the refundable portion was changed to be the greater of:

- a percentage of earned income over a minimum amount for all families regardless of the number of children, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit (the provision that was already in law).

The 2001 law set the minimum amount at $10,000 and provided for it to increase annually for inflation. The American Recovery and Reinvestment Act of 2009 temporarily reduced the indexed $10,000 to $3,000 for tax years 2009 and 2010 only; TRUIRJCA extended the $3,000 threshold to 2011 and 2012. Unless Congress extends the expanded refundability of the credit, in 2013 only families with three or more children will be able to claim the credit as a refund, and the refund will be limited to payroll taxes in excess of the federal earned income tax credit.

How much do Minnesotans claim?

In tax year 2009, 429,237 federal income tax returns filed by Minnesotans claimed $577 million in the nonrefundable portion of the federal child credit. The average amount claimed was $1,344. For the same year, 260,508 returns filed by Minnesotans claimed $348 million under the refundable additional child credit. Some of these returns also claimed the nonrefundable portion of the credit. The average additional child tax credit was $1,336.

What is the effect of the TRUIRJCA sunset on the federal child credit?

Most provisions extended by TRUIRJCA will expire after tax year 2012. Included among the provisions subject to sunset are:

- the increase in the child tax credit from the $500 per child amount set in the late 1990s to $1,000, and
- allowing the credit to be claimed as a refund equal to a percentage of earned income over a threshold.

Unless Congress extends those provisions beyond 2012, in 2013 the per-child credit amount will decrease from $1,000 to $500 and the credit will be refundable only for households with three or more children, and only to the extent that their payroll taxes exceed the federal earned income tax credit.

The number of Minnesota households that claim the child tax credit is expected to fall by about 130,000 filers to 430,000 in tax year 2013 as a result of the TRUIRJCA sunset, and the total amount claimed by Minnesota filers is estimated to decrease by about $560 million to $350 million. The $560 million decrease will consist of a reduction of about $325 million in the nonrefundable portion of the credit and of about $235 million in the refundable portion.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204.

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