Short Subjects

Minnesota House of Representatives, House Research

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HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: January 2014

Motor Vehicle Sales Tax

The motor vehicle sales tax (MVST) has become a key funding source for transportation, although historically it had not been allocated solely to transportation. A constitutional amendment passed in 2006 resulted in 100 percent of MVST revenue going to transportation purposes.

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 based on the purchase price. It is imposed instead of the general sales tax. Some older autos as well as collector's vehicles have a flat tax instead. Minn. Stat. §§ 297B.02, 297B.025. MVST is collected by auto dealers at the time of sale or by registrars when the vehicle is registered (for private sales).

Periodic allocation to transportation

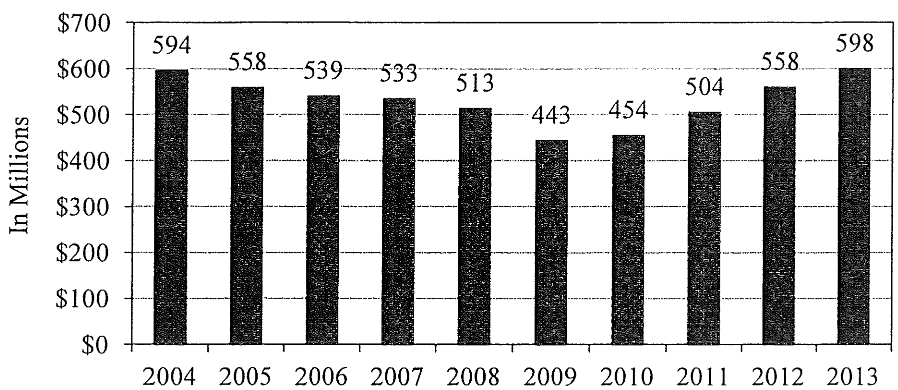
MVST revenue has historically been allocated both to the state's general fund and to transportation purposes. The legislature first directed a portion to highways and transit in 1981. Over the ensuing years, allocations to transportation were periodically changed and suspended.

A series of legislative changes over 2000 to 2003 resulted in increased MVST revenue distributed to roads and transit. Changes prompting MVST reallocations included (1) placing caps on the amount of registration taxes (tab fees) collected on motor vehicles (which were subsequently removed in 2008); and (2) eliminating local property taxes as a key funding source for Twin Cities metropolitan area transit operations. The allocation adjustments also provided funding for the state's share of light rail transit operations and shifted some MVST highway funds to instead go to transit.

Overall, the shifts of the early 2000s did not result in substantial increases in transportation funding. Rather the additional MVST allocations served to offset reductions in other transportation funding sources (such as property taxes and the general fund).

MVST revenue

MVST Revenue History
FY 2004-2013



The 2006 constitutional amendment

At the 2006 general election voters approved a constitutional amendment dedicating all MVST revenue to transportation purposes. The constitutional language establishes a floor for allocation to transit and a ceiling for allocation to highways, requiring that:

- "not less than 40 percent" go to public transit assistance; and
- "no more than 60 percent" of the revenue go to the Highway User Tax Distribution (HUTD) fund, which is dedicated to state and local highways. Minn. Const. art. XIV, § 13.

The amendment also included a phase-in period for shifting revenue from the state's general fund to transportation; this occurred over fiscal years 2008 to 2012.

MVST allocation

Within the constitutional limits, the legislature can set by statute the actual division between highways and transit. Legislation passed in 2007 allocated MVST revenue for the phase-in period and after. It was modified in 2009 by shifting additional funds from highways to transit for fiscal years 2010 and 2011 only (which was designed to help address reductions in transit funding from the general fund). Minn. Stat. § 297B.09.

Since fiscal year 2012 (at completion of the phase-in), revenue is distributed 60 percent to highways and 40 percent to transit. The transit portion consists of 36 percent for the Twin Cities metropolitan area and 4 percent for Greater Minnesota.

MVST Allocation

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012+
HUTD fund	38.25%	44.25%	47.50%	54.50%	60.00%
Metropolitan transit	24.00	27.75	31.50	35.25	36.00
Greater MN transit	1.50	1.75	4.75	4.00	4.00
General fund	36.25	26.25	16.25	6.25	0.00

Note: Percentage allocations for transit in fiscal years 2010-11 do not account for additional dollar amount caps.

Revenue from the constitutional amendment

Additional revenue for transportation purposes attributable to the constitutional amendment amounts to $1.01 billion over fiscal years 2008 to 2013, summarized in the table below. There is a corresponding reduction in revenue to the general fund.

Transportation Funding from the Constitutional Amendment

	FY 2008-2013
HUTD fund	$596.1
Metropolitan transit	351.9
Greater Minnesota transit	64.4
Total	**1,012.4**

Note: Amounts are in millions.

For more information: See the House Research publication *Motor Vehicle Sales Tax Chronology*, August 2009.

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Andrew Biggerstaff & Deborah Dyson

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Subordinate Service Districts

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

What is a subordinate service district?

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

What services can be provided in a subordinate service district?

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

How are the services paid for?

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

How is the way services are paid for different from other ways of paying for improvements or services?

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

How is a subordinate service district formed?

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

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

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

Can a district be enlarged?

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

How is a district discontinued?

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

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

For more information: Contact legislative analyst Andrew Biggerstaff at andrew.biggerstaff@house.mn or Deborah Dyson at deborah.dyson@house.mn. Also see the House Research publication *City Special Service Districts*.

HOUSE RESEARCH | **Short Subjects**

Mark Shepard

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State Agency Head Salaries

The governor establishes most agency head salaries

The governor establishes the salaries for most state executive branch agency heads, within limits set in law. For most agency heads, the limit is 133 percent of the governor's salary, to be adjusted for inflation each January. For several, the limit is 120 percent of the governor's salary, to be adjusted for inflation each January. Minn. Stat. § 15A.0815, subds. 2 and 3. Individual agency head salaries within the limits set in law are not subject to legislative approval.

The current limit for most agency heads is $161,603 (133 percent of the governor's current salary of $120,303, with an inflation adjustment applied in January 2014). The agency head salary limits will increase on January 1, 2015, and again on January 1, 2016, both because of the inflation adjustment and because the governor's salary is scheduled to increase by 3 percent on each of those dates. As indicated in the table below, none of the agency head salaries currently is close to the limit.

The legislature changed this system in 2013. Before the 2013 changes, agency head salaries were limited to 95 percent (or in several cases 85 percent) of the governor's salary, and individual agency head salaries within the salary limits required legislative approval.

There is a different process for setting some agency head salaries

There is a different process for setting salaries for heads of the statewide public pension funds, the lottery director, and the executive director of the State Board of Investment.

- For directors of the three statewide public pension funds, the governing board of the applicable pension system sets the salary, within the statutory limit of 133 percent of the governor's salary. These salaries are subject to legislative approval.
- The lottery director salary is set in statute at 95 percent of the governor's salary. Minn. Stat. § 349A.02, subd. 1.
- The salary for the executive director of the State Board of Investment is set by the board, under a compensation plan approved by the Subcommittee on Employee Relations of the Legislative Coordinating Commission and the full legislature. Minn. Stat. §§ 11A.04, cl. 14, and 43A.18, subd. 3b.

Agency head salaries

The following table lists the salaries, as of January 2014, for agency heads who are subject to the salary limits specified in statute. Most of the cabinet agency salaries were last increased by 5 percent as of January 2013 and by 5 percent as of January 2014. Before that, most salaries were last increased in 2000.

Cabinet Agencies	**Salaries**
Administration	$119,517
Agriculture	119,517
Commerce	119,517
Corrections	119,517
Education	119,517
Employment and Economic Development	119,517
Health	119,517
Office of Higher Education	119,517
Housing Finance Agency	119,517
Human Rights	119,517
Human Services	143,281
Iron Range Resources and Rehabilitation	105,465
Labor and Industry	119,517
Management and Budget	119,517
Mediation Services	105,465
Natural Resources	119,517
Pollution Control Agency	119,517
Public Safety	119,517
Revenue	119,517
Transportation	119,517
Veterans Affairs	119,517
Other Agencies	
Gambling Control Board	$95,067
Metropolitan Airports Commission, Chair	20,833
Metropolitan Council, Chair	58,489
Ombudsman for Mental Health and Retardation	97,510
Pari-mutuel Racing	88,455
Public Utilities Commission	92,853
Minnesota State Retirement System	114,288
Public Employees Retirement Association	114,288
Teachers Retirement Association	114,288

For more information: Contact legislative analyst Mark Shepard at 651-296-5051. Also see the House Research publication *State Elected Officials' Compensation*, November 2013.

HOUSE RESEARCH | Short Subjects

Nina Manzi
Updated: January 2014

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 (FTI) after Minnesota additions and subtractions.

What are Minnesota additions to taxable income?

Minnesota requires various *additions* to federal taxable income for tax year 2013. These items are subject to Minnesota tax, but not federal tax. Minnesota has not conformed to changes to the federal definition of income for tax year 2013, so there are a large number of additions in effect. The most significant additions for tax year 2013 are:

- **State income tax and mortgage insurance premiums tax deductions.** Filers who claimed a federal itemized deduction for state income taxes paid or for mortgage insurance premiums 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.
- **The additional standard deduction amount for married filers** at the federal level that makes the deduction twice that for single filers.
- **Bond interest and mutual fund interest dividends paid by non-Minnesota state and local governments.**
- **Higher education tuition and educator classroom expenses** deducted at the federal level.
- **Employer-provided education assistance, and a portion of employer-provided adoption assistance,** to the extent excluded at the federal level.
- **80 percent of the difference between federal and state allowances for bonus depreciation and section 179 expensing.**
- **Discharge of indebtedness on principal residences.**
- **Net operating losses allowed at the federal level under a different schedule than at the state level.**
- **Student loan interest** deducted at the federal level is subject to phaseout at lower income levels at the state level; the difference is a state addition.
- **Expenses relating to income not taxed by Minnesota.**
- **Capital gain part of lump-sum distributions from qualified retirement plans.**

What subtractions does Minnesota allow from taxable income?

Minnesota allows various *subtractions* from federal taxable income for tax year 2013. The estimated reductions in revenue shown below are taken from the Department of Revenue's *Tax Expenditure Budget for 2012-2015*. Revenue estimates made during the 2014 legislative session will differ because they will be based on a more recent economic forecast. Subtractions for tax year 2013 include:

- **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** ($18.6 million in fiscal year 2014). 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** ($10.3 million in fiscal year 2014).
- **Compensation for most military service in Minnesota** ($3.8 million in fiscal year 2014). Allowed for state active service, federally funded state active service (generally floods, other disasters, and airport security), active service in the full-time military by Minnesota residents, and training pay.
- **50 percent of charitable contributions in excess of $500** ($8.0 million in fiscal year 2014). Allowed only for filers who do not claim federal itemized deductions—those who itemize have already deducted their charitable contributions in computing federal taxable income.
- **Minnesota elderly/disabled exclusion** ($0.7 million in fiscal year 2014). 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** ($3.0 million in fiscal year 2014). 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 2014). 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 2014). 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 2014). 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 derived from a 2009 Department of Revenue bill analysis).
- **National service education awards** ($100,000 in fiscal year 2014). 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. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, August 2013; and *Minnesota's Elderly Exclusion* (web only) on the income tax page of the House Research website: www.house.mn/hrd/.

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 allows up to $2,500 to be deducted for each dependent in grades 7-12 and up to $1,625 for each dependent in grades K-6.

In tax year 2011 (fiscal year 2012) an estimated 222,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will cost the state $19.0 million in tax year 2014 (fiscal year 2015).

What expenses qualify for the deduction?

Qualifying expenses for the deduction include payments for:

- 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 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 2011, 57,331 Minnesotans claimed a total of $15.7 million in K-12 education credits. The average credit was $273. In tax year 2014 (fiscal year 2015), the Department of Revenue estimates that Minnesota will claim $13.9 million in K-12 education credits.

What expenses qualify for the credit?

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

What are the tax benefits of the deduction and credit?

The deduction reduces an individual's taxable income. The tax benefit of the deduction depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has four marginal tax rates: 5.35 percent, 7.05 percent, 7.85 percent, and 9.85 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 9.85 percent bracket with the same deduction will pay $246.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2014, a typical married couple with two dependents would need to have $26,150 of gross income before owing any state income tax.

The credit, in contrast, 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-1M, income additions and subtractions. 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, 13 states in addition to Minnesota provide income tax benefits for education-related expenses. **Alabama, Arizona, Florida, Georgia, Indiana, Iowa, Louisiana, New Hampshire, Oklahoma, Pennsylvania, Rhode Island, South Carolina,** and **Virginia** all provide tax credits for contributions to nonprofit school tuition organizations that operate like charities; Puerto Rico also allows a similar credit. **New Hampshire, 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 **Alabama, Arizona, Georgia, Indiana, Iowa, Louisiana, Oklahoma, South Carolina,** and **Virginia** 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 nonrefundable tax credits 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, Indiana, 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.

Nina Manzi

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The Minnesota and Federal Dependent Care Tax Credits: An Overview

What are the credits?

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

Are the credits refundable?

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

Who is eligible for the credits?

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

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

What are qualifying expenses?

Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include amounts paid to the claimant's spouse or another dependent.

Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse). Maximum allowable qualifying expenses are reduced by amounts paid through dependent care pre-tax accounts.

How are the credits calculated?

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

The *state credit* equals the lesser of $720 for one child ($1,440 for two or more children), or the federal credit as calculated using the parameters in effect prior to 2003. Under the pre-2003 federal credit, the maximum qualifying expenses are $2,400 for one child ($4,800 for two or more children), and the phase down begins when income reaches $10,000, not $15,000. The state credit is calculated by reference to the recalculated federal credit for which the claimant is eligible, not the amount the claimant could have used to offset federal liability.

The state credit is subject to an income phaseout. (By contrast, the federal credit rate phases down to a minimum percentage but is never totally phased out.) In tax year 2014, the state phaseout begins when income exceeds $25,350, and the state credit is fully phased out when income exceeds $39,000. The income threshold for the phaseout is adjusted each year for inflation.

How do filers claim the credits?

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

How many Minnesotans claim the credits?

In tax year 2011, 146,706 Minnesotans claimed the federal dependent care credit and 36,469 claimed the state credit. These claims represent 5.6 percent of all federal returns filed by Minnesotans and 1.4 percent of all state returns filed.

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

Because the state credit is refundable and subject to an income-based phaseout (from $23,720 to $37,370 in tax year 2011, the year of the data), most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2011, Minnesotans claimed $67.9 million of federal dependent care credits. The average federal dependent care credit was $463.

In tax year 2011, Minnesotans claimed $14.6 million of state dependent care credits. The average state dependent care credit was $400.

How does Minnesota compare with other states?

Nationwide, 4.2 percent of all income tax returns claimed the federal dependent care credit, compared to 5.6 percent in Minnesota. Nebraska and South Dakota had the highest percentage of returns claiming the federal credit at 6.2 percent, and West Virginia had the lowest at 2.2 percent.

The average federal dependent care credit in 2011 was $535 nationwide and $463 in Minnesota. New York had the highest average credit at $596, and Montana had the lowest at $453. Minnesota's average credit amount may be lower than the national averages because state residents have above-average incomes, or because Minnesotans are more likely to receive child care assistance or use pre-tax dependent care accounts, reducing the amount of qualifying expenses.

How is Minnesota affected by the ATRA changes to the federal credit?

In the 2013 session, Minnesota did not enact legislation to conform the state credit calculation phaseout to the larger federal credit allowed under the American Taxpayers Relief Act of 2012 (ATRA). As a result, Minnesota claimants will have to determine their state credit by reference to the smaller federal credit that would have been in effect had ATRA not been enacted. That is because ATRA increased the federal credit for tax year 2013, relative to prior federal law.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, August 2012.

Nina Manzi Updated: January 2014

The Federal Earned Income Tax Credit and Minnesota Working Family Credit: An Overview

What are the credits?

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

Who is eligible for the credits?

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2014, individuals with more than $3,350 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

How are the credits calculated?

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2014, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

	Maximum credit		**Phaseout threshold**		**Income at which credit fully phased out**	
	EITC	WFC	EITC	WFC	EITC	WFC
Unmarried claimants						
No children	$496	$124	$8,110	$8,110	$14,590	$14,600
1 child	$3,305	$990	$17,830	$21,190	$38,511	$38,472
2 children	$5,460	$1,910	$17,830	$25,130	$43,756	$43,674
3 or more children	$6,143	$1,910	$17,830	$25,130	$46,997	$43,674
Married claimants						
No children	$496	$124	$13,540	$8,110	$20,020	$14,600
1 child	$3,305	$990	$23,260	$21,190	$43,941	$38,472
2 children	$5,460	$1,910	$23,260	$25,130	$49,186	$43,674
3 or more children	$6,143	$1,910	$23,260	$25,130	$52,427	$43,674

How do filers claim the credits?

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

How many Minnesotans claim the credits?

In tax year 2011, 355,940 Minnesota returns claimed the EITC and 344,367 claimed the WFC. These claims represent 13.7 percent of all federal returns filed by Minnesotans and 12.9 percent of all state returns filed by Minnesota residents. The number of EITC claims exceeds the number of WFC claims mostly because in 2011 the higher EITC rate for families with three or more children resulted in the EITC for large families extending to higher incomes than did the WFC, which did not have a higher rate for families with three or more children.

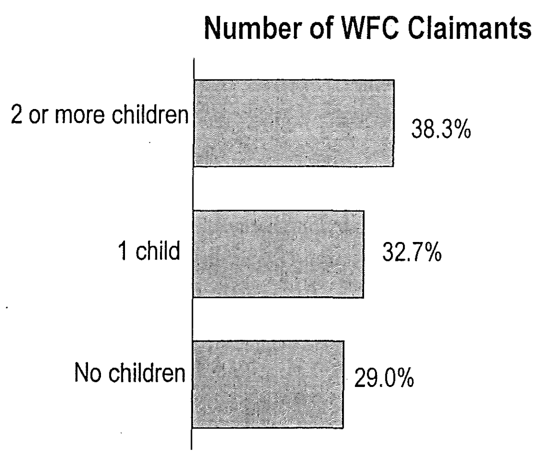
How much is paid out in credits?

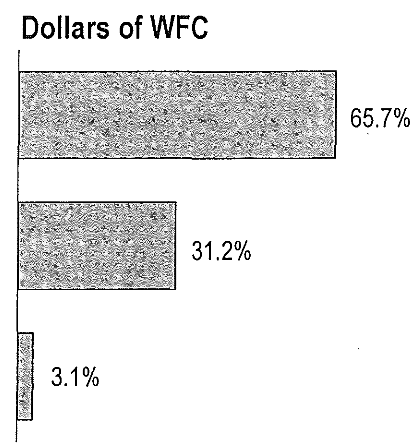
In tax year 2011, Minnesotans claimed $696 million in EITC, of which $82 million offset tax liability, and the remaining $614 million was paid as a refund. The average EITC claimed by Minnesotans was $1,955.

Minnesota returns claimed an additional $209 million in WFC, of which $40 million offset tax liability, and the remaining $169 million was paid as a refund. The average WFC was $606.

How are the credits distributed among different types of families?

Seventy-one percent of all working family credits went to families with one or more children. These families received about 97 percent of the total amount of credits paid in 2011. Individuals without children filed 29.0 percent of returns claiming credits, but received only 3.1 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children. The distribution of earned income tax credits is similar.





How are the credits distributed geographically?

Under half (48 percent) of the returns claiming credits came from the Twin Cities metropolitan area, but these seven counties generated about 51 percent of all income tax returns filed. Put another way, in 2011, as in previous years, nonmetro filers were slightly more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 19.1 percent of all income tax returns claimed the EITC, compared to 13.7 percent in Minnesota. The average EITC nationwide in 2011 was $2,252; it was $1,955 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

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

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, March 2013.

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

Deborah Dyson and Mark Shepard

Updated: January 2014

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, 2014, the limit is $162,245. (For more information see the Minnesota Management and Budget (MMB) website at http://www.beta.mmb.state.mn.us/salary-cap.) In 2013, the legislature provided for the governor's salary to increase by 3 percent in 2015 and by 3 percent in 2016. Laws 2013, ch. 142, art. 6, § 12.

The compensation limit for local government employees 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, 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 Management and Budget 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, 2014, a local government may increase by 1 percent the compensation of an employee with an existing waiver for compensation to exceed $132,333. If the existing approved waiver amount is below $162,245, the local government may increase an employee's compensation to the $162,245 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.

The local government limits do not apply to state employees

The statute limiting political subdivision salaries does not cover state employees. State law assigns executive branch agency heads to two salary ranges, which are capped at 133 percent and 120 percent of the governor's salary. Minn. Stat. § 15A.0815, subds. 2 and 3. (These limits are adjusted annually for inflation.) Until 2013, the salary of employees of executive branch agencies was limited to the salary of the agency head, but this limit was repealed in 2013. Salaries for these employees are set by collective bargaining agreements or compensation plans that are approved by the legislature.

For more information: Contact legislative analysts Deborah Dyson at deborah.dyson@house.mn or Mark Shepard at 651-296-5051. Also see the House Research publications *State Agency Head Salaries*, January 2014, and *State Elected Officials' Compensation*, November 2013.

Nina Manzi

Updated: February 2014

Minnesota's Individual Income Tax

How much are income tax revenues?

Minnesota's income tax revenues are projected to equal $9.445 billion in fiscal year 2014, about 44 percent of state tax collections and 38 percent of all state revenues.

What is the tax base used to calculate Minnesota's income tax?

Minnesota's income tax applies to a base of Minnesota taxable income (MTI). The starting point for calculating MTI is federal taxable income (FTI), which is the income measure used in determining federal income tax liability. In calculating MTI, taxpayers are required to add certain types of income to FTI and allowed to subtract other kinds of income. Some of the subtractions are required under federal law. For more detail on these adjustments, see the House Research publication *Minnesota Taxable Income,* January 2014.

What are the income tax rates and brackets?

Minnesota's income tax is a graduated tax, with four rates: 5.35 percent, 7.05 percent, 7.85 percent, and 9.85 percent. The rates are applied to income brackets that vary by filing status. Married couples filing joint returns are allowed the most generous (widest) brackets, followed by head of household filers (single parents maintaining a household), unmarried single filers, and married separate filers.

The table shows the income tax brackets in effect for each rate in tax year 2014 (brackets for married taxpayers, filing separately, are half the width of the married joint brackets):

	Married Joint	Single	Head of Household
5.35%	First $36,080	First $24,680	First $30,390
7.05%	$36,081 to $143,350	$24,681 to $81,080	$30,391 to $122,110
7.85%	$143,351 to $254,240	$81,081 to $152,540	$122,111 to $203,390
9.85%	All over $254,240	All over $152,540	All over $203,390

A married couple filing a joint return owes income tax equal to 5.35 percent of their first $36,080 of taxable income, 7.05 percent of income from $36,081 to $143,350, 7.85 percent of taxable income from $143,351 to $254,240, and 9.85 percent of taxable income over $254,240. The income tax brackets are adjusted each year for inflation.

What income tax credits does Minnesota allow?

Minnesota allows taxpayers to claim several credits against tax liability. Credits that may be used only to reduce liability, called nonrefundable credits, include the following (and the amount claimed most recently):

- Credit for taxes paid to other states ($232.9 million in tax year 2012)
- Marriage credit ($79.5 million in fiscal year 2014)
- Credit for past military service ($300,000 in fiscal year 2014)
- Long-term care insurance credit ($8.0 million in fiscal year 2014)

- Research and development credit ($13.2 million in fiscal year 2014)
- Employer transit pass credit ($100,000 in fiscal year 2014)

In addition, in tax year 2014 Minnesota allows nine refundable credits, which are paid as refunds to taxpayers even if the credit amount is greater than their income tax liability (and the amount refunded most recently):

- Working family (earned income) credit ($200.1 million in fiscal year 2014)
- Dependent care credit ($12.7 million in fiscal year 2014)
- K-12 education credit ($13.6 million in fiscal year 2014)
- Military combat zone credit ($2.1 million in fiscal year 2014)
- Job opportunity building zone (JOBZ) credit ($1.6 million in fiscal year 2014)
- Bovine tuberculosis testing credit (none allowed in fiscal year 2014; no testing required)
- Enterprise zone credit ($100,000 in fiscal year 2014)
- Angel investment credit ($12.0 million in fiscal year 2014)
- Historic structure rehabilitation credit ($17.1 million in fiscal year 2014)
    - the historic credit is available to both corporate and individual taxpayers; to date most claims have come from corporate taxpayers.

Credit amounts are from the Minnesota Department of Revenue's *Tax Expenditure Budget, Fiscal Years 2014-2017,* Department of Revenue estimates, and income tax return processing data.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at joel.michael@house.mn. Also see the House Research publications, *Minnesota Taxable Income*, January 2014; *The Minnesota Income Tax Marriage Credit*, November 2013; *The Minnesota and Federal Dependent Care Tax Credits*, August 2012; *The Federal Earned Income Credit and the Minnesota Working Family Credit,* March 2013; *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2011; and *Income Tax Terms: Deductions and Credits*, August 2013.

Nina Manzi and Janelle Taylor

Updated: February 2014

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 state's nongame wildlife fund. Corporate taxpayers may also contribute on their corporate franchise tax returns. 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. The checkoff was enacted and first appeared on tax forms in 1980.

How much do taxpayers contribute to the nongame wildlife checkoff?

In 2012, over 61,000 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 about $17. About 1.8 percent of all filers made contributions—2.0 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 was about 3 percent in the mid-2000s, and has since leveled off at about 2 percent.

Nongame Wildlife Checkoff Contributions, 1998 to 2012

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
2010	1.9	1,061,164	17.09
2011	1.9	1,052,251	16.12
2012	1.8	1,049,809	17.03

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 including:

- Stabilizing and increasing the populations of the species;
- Improving knowledge of the species; and
- 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, golden 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 28. Only four states offer only the nongame wildlife checkoff—Indiana, Minnesota, Nebraska, 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**

Nina Manzi and Andrew Biggerstaff **Updated: February 2014**

Military Pay under Minnesota's Individual Income Tax

Most military pay is exempt from Minnesota income tax

Calculation of Minnesota's individual income tax starts with a person's federal taxable income. As a result, military pay that is exempt from taxation at the federal level, such as combat pay and hazardous duty pay, is also exempt at the state level. Minnesota allows subtraction from federal taxable income of most other types of military pay that are taxed at the federal level, thereby making such income exempt from Minnesota income tax. However, no subtraction is allowed for pay for either of the two following types of military service:

(1) service by a Minnesota resident serving in the National Guard while assigned to Active Guard and Reserve (AGR) status under U.S. Code, title 32

(2) service performed in accordance with Minnesota Statutes, section 190.08, subdivision 3 (i.e., current or former military personnel employed for the full-time administration of the Minnesota Department of Military Affairs)

Federal law prohibits states from taxing some types of military income

Federal law prohibits states from taxing active service military pay earned by nonresidents. Thus, nonresidents with Minnesota income from military pay often do not need to file Minnesota tax returns.

Military pay for regular full-time active service is generally not taxed by the state

Minnesota also allows for the subtraction of military pay earned by a Minnesota resident for full-time active military service (other than for the two types of military service described above). This subtraction typically applies to Minnesota residents who serve either within Minnesota as full-time military recruiters or Coast Guard personnel, for example, and to Minnesota residents who are in full-time military service outside Minnesota.

Military pay for most types of National Guard and reserve service is not taxed by the state

A member of the National Guard or other military reserve unit is allowed to subtract pay received for active service.

"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. Code, 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);
- federal active service, under U.S. Code, 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 U.S. Code, title 10; active duty orders while recuperating from an injury; and Active Guard and Reserve (AGR) service under U.S. Code, title 10 (Minn. Stat. § 190.05, subd. 5c).

"Active service" does not include service by Minnesota residents working in AGR status under U.S. Code, title 32 (federally funded state active service), nor service by current or former members of the National Guard or reserves ordered to active service by the adjutant general to perform full-time administration of the Department of Military Affairs.

Military pay for service outside Minnesota is generally not taxed by the state

Income received by Minnesota residents for military service under U.S. Code, title 10, including service in AGR status by members of the military reserves other than the National Guard, is not taxed by the state of Minnesota, and thus is not subject to Minnesota income tax withholding.

Unless a service member who has served only outside Minnesota during the year is due some specific tax-related benefit from the state (e.g., a refundable tax credit), has had other income tax withheld, or has earned a sufficient amount ($10,000 or more for tax year 2013) of other taxable military and/or nonmilitary income to require filing, it may not be necessary for the person to file a Minnesota income tax return for a given tax year.

The following are some common types of income received by Minnesota residents that are normally subject to the Minnesota income tax, regardless of whether the service member has been serving outside of Minnesota during part or all of the year:

- income earned by the service member's spouse living and employed within Minnesota (when filing jointly)
- nonmilitary income earned by the service member as a pay differential provided by the person's (public or private) Minnesota civilian employer
- nonmilitary income earned by the service member from civilian employment within Minnesota during part of the year (e.g., preceding or following military deployment or transfer)
- other nonmilitary income earned by the service member before, during, or following military deployment outside Minnesota (e.g., rental income from property in Minnesota)

For more information: The Department of Revenue maintains information on taxation of military pay online at http://www.revenue.state.mn.us/individuals/individ_income/Pages/Members_of_the_Military.aspx or contact legislative analyst Nina Manzi at 651-296-5204 or Andrew Biggerstaff at andrew.biggerstaff@house.mn.

HOUSE RESEARCH | Short Subjects

Nina Manzi and Andrew Biggerstaff **Updated: February 2014**

Minnesota Income Tax Credit for Past Military Service

What is the income tax credit for past military service?

The credit for past military service equals $750 for qualifying individuals. It is nonrefundable and is subject to an income limitation. The credit took effect in tax year 2009 and was first claimed on tax year 2009 returns filed in 2010. Eligible individuals use form M-1C to claim the credit as part of their income tax return.

Who qualifies for the credit for past military service?

To qualify for the credit, a veteran must:

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

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

What is a nonrefundable credit?

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

In tax year 2014, a single veteran with no dependents who claims the standard deduction would need to have $24,069 of federal adjusted gross income (FAGI) to receive the full $750 credit.

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

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

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

How is the military service credit income limited?

The military service credit is phased out for individuals with FAGI of $30,000 or more. The credit is reduced by 10 percent of FAGI in excess of $30,000, so that individuals with FAGI over $37,500 are not eligible for any portion of the credit.

FAGI is calculated on the federal tax forms (Form 1040, 1040A, or 1040EZ). It includes most kinds of income, such as:

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

Some of the major items excluded from FAGI are:

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

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

A qualifying veteran with less than $30,000 in taxable military retirement income and no other income other than Social Security would qualify for part or all of the credit, depending on the individual's tax liability. Since Social Security benefits are not included in FAGI for low-income filers, receipt of Social Security will not subject an individual to the income-based phaseout.

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

How many individuals claimed the credit in 2012, and how much did they claim?

In tax year 2012, 1,631 returns claimed just over $1 million in credits, for an average of $681. The number of claims and amount claimed has been stable since the credit took effect, and has been substantially lower than the estimate prepared when the credit was enacted in 2008, which projected that about 14,000 veterans would claim $10.3 million in credits.

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

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Joel Michael **Updated: June 2014**

Capital Gains Taxation: Federal and State

What is capital gains income?

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

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

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

How does the federal government tax capital gains income?

Three maximum federal income tax rates apply to most types of net long-term capital gains income in tax year 2014:

- 0 percent for taxpayers in the 10 percent or 15 percent bracket for ordinary income (under $73,800 for married joint filers)
- 15 percent for taxpayers above the 15 percent bracket but below the 39.6 percent bracket (from $73,800 to $457,600 for married joint filers)
- 20 percent for taxpayers in the top 39.6 percent bracket ($457,600 or higher for married joint filers)

The net capital gain income that qualifies for the preferential rates is long-term capital gain after subtracting both long-term capital losses and net short-term capital losses (i.e., in excess of short-term capital gains). Short-term capital gains do not qualify for the preferential federal rates but are taxed as ordinary income.

Are there higher or lower rates for certain kinds of income?

Three exceptions to the maximum federal rates apply:

- **Qualified small business stock.** Between 50 percent and 100 percent of the gain on sale of qualified small business stock is excluded from taxable income, depending on when the stock was acquired; any remaining gain is subject to a maximum rate of 28 percent
- **Collectibles.** The net capital gain from selling collectibles (such as coins or art) is subject to a maximum 28 percent rate
- **Section 1250 real property.** The part of any net capital gain on property for which the taxpayer claimed "additional depreciation" (Section 1250 real property) is taxed at a maximum 25 percent rate

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

Yes. Taxpayers who meet "use" and "ownership" tests may exclude up to $250,000 of gain on the sale of the home ($500,000 for married joint taxpayers). Under the "use" test, the taxpayer must have used the home as his or her principal residence for two of the five years preceding the sale. Under the "ownership" test, the taxpayer must have owned the home for at least two years. There is no limit to the number of times a taxpayer may claim this exclusion. Beginning in January 2009, the exclusion is apportioned based on the amount of time in which the home was used as the principal residence, from January 2009 to the time of sale.

Can capital losses reduce ordinary income?

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

How does Minnesota tax capital gains income?

Minnesota includes all net capital gains income in taxable income and subjects it to the same tax rates as apply to other income: 5.35, 7.05, 7.85, and 9.85 percent. Minnesota recognizes the federal exclusions on the sale of the taxpayer's home and all or part of the gain on qualified small business stock.

How do other states that impose an individual income tax treat capital gains income in tax year 2013?

- Eight states (**Arkansas, Hawaii, Montana, New Mexico, North Dakota, South Carolina, Vermont,** and **Wisconsin**) exclude a portion of long-term capital gains income, provide a lower rate, or allow a credit
- 32 states, including Minnesota, do not provide general preferential treatment for capital gains income; many provide special treatment for capital gains income from specific types of assets:
    - 16 states and the **District of Columbia** have preferential treatment of long-term gains on a certain (usually in-state) investments, such as in new business, farmland or other real estate, or low-income housing. Two courts have held restrictions to in-state investments unconstitutionally discriminate against interstate commerce
    - Seven states exclude gains on some or all federal, state and local bonds
    - Three states allow exclusion of all or part of certain capital gains income under a more general exclusion for retirement income

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

In tax year 2011, about 19 percent of all returns filed by Minnesota residents reported some capital gain or loss. Married taxpayers filing joint returns reported 80 percent of capital gains income. Filers with incomes over $100,000 reported over 90 percent of capital gains income.

Federal adjusted gross income	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains only	
Less than $50,000	$197	4.2%	9.9%	$1,134
$50,000 to $99,999	$266	5.6%	2.8%	$2,027
$100,000 to $500,000	$1,363	28.7%	4.8%	$8,631
Over $500,000	$2,921	61.5%	16.7%	$219,327
All incomes	$4,747	100.0%	8.2%	$9,963

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

Almost 40 percent of taxpayers aged 65 and older reported some capital gains income in tax year 2011. The table shows the percent of gains by age of taxpayer.

Taxpayer age	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains	
Less than 25	$18	0.4%	5.6%	$670
25 to 39	$356	7.5%	5.4%	$6,092
40 to 64	$2,811	59.2%	7.5%	$11,875
65 or older	$1,563	32.9%	11.6%	$10,086
All ages	$4,747	100.0%	8.2%	$9,963

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at joel.michael@house.mn.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi

Updated: June 2014

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 (FTI) after Minnesota additions and subtractions.

What are Minnesota additions to taxable income?

Minnesota requires various *additions* to federal taxable income for tax year 2013. These items are subject to Minnesota tax, but not federal tax. At the start of the 2013 filing season Minnesota had not conformed to federal changes to the definition of income for tax year 2013, with state tax forms requiring additions for various deductions allowed at the federal level. Midway through the filing season, Minnesota retroactively conformed to the federal definition of income for tax year 2013 in Laws 2014, chapter 150. The Department of Revenue revised state tax forms, approved updated tax preparation software, and corrected returns for affected taxpayers who had already filed, to the extent possible. Some taxpayers were contacted and asked to file amended returns. The most significant additions remaining in effect for tax year 2013 after enactment of chapter 150 are the following:

- **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.
- **The additional standard deduction amount for married filers** at the federal level that makes the deduction twice that for single filers (chapter 150, conformed to the additional standard deduction beginning in tax year 2014, when this addition will no longer be required).
- **Bond interest and mutual fund interest dividends paid by non-Minnesota state and local governments.**
- **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.**
- **Expenses relating to income not taxed by Minnesota.**
- **Capital gain part of lump-sum distributions from qualified retirement plans.**

What subtractions does Minnesota allow from taxable income?

Minnesota allows various *subtractions* from federal taxable income for tax year 2013. The estimated reductions in revenue shown below are taken from the Department of Revenue's *Tax Expenditure Budget for 2012-2015*. Subtractions for tax year 2013 include:

- **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** ($18.6 million in fiscal year 2014). 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** ($10.3 million in fiscal year 2014).
- **Compensation for most military service in Minnesota** ($3.8 million in fiscal year 2014). Allowed for state active service, federally funded state active service (generally floods, other disasters, and airport security), active service in the full-time military by Minnesota residents, and training pay.
- **50 percent of charitable contributions in excess of $500** ($8.0 million in fiscal year 2014). Allowed only for filers who do not claim federal itemized deductions—those who itemize have already deducted their charitable contributions in computing federal taxable income.
- **Minnesota elderly/disabled exclusion** ($0.7 million in fiscal year 2014). 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** ($3.0 million in fiscal year 2014). 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 2014). 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 2014). 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 2014). 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 derived from a 2009 Department of Revenue bill analysis).
- **National service education awards** ($100,000 in fiscal year 2014). 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 analyst Nina Manzi at 651-296-5204. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, August 2013; and *Minnesota's Elderly Exclusion* (web only) on the income tax page of the House Research website: www.house.mn/hrd/.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: June 2014

The Federal Earned Income Tax Credit and Minnesota Working Family Credit: An Overview

What are the credits?

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

Who is eligible for the credits?

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2014, individuals with more than $3,350 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

How are the credits calculated?

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2014, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

	Maximum credit		**Phaseout threshold**		**Income at which credit fully phased out**	
	EITC	WFC	EITC	WFC	EITC	WFC
Unmarried claimants						
No children	$496	$130	$8,110	$8,130	$14,590	$14,587
1 child	$3,305	$1,040	$17,830	$21,190	$38,511	$38,461
2 children	$5,460	$2,006	$17,830	$25,130	$43,756	$43,673
3 or more children	$6,143	$2,006	$17,830	$25,130	$46,997	$43,673
Married claimants						
No children	$496	$130	$13,540	$13,560	$20,020	$20,017
1 child	$3,305	$1,040	$23,260	$26,620	$43,941	$43,891
2 children	$5,460	$2,006	$23,260	$30,560	$49,186	$49,103
3 or more children	$6,143	$2,006	$23,260	$30,560	$52,427	$49,103

How do filers claim the credits?

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

How many Minnesotans claim the credits?

In tax year 2011, 355,940 Minnesota returns claimed the EITC and 344,367 claimed the WFC. These claims represent 13.7 percent of all federal returns filed by Minnesotans and 12.9 percent of all state returns filed by Minnesota residents. The number of EITC claims exceeds the number of WFC claims mostly because in 2011 the higher EITC rate for families with three or more children resulted in the EITC for large families extending to higher incomes than did the WFC, which did not have a higher rate for families with three or more children.

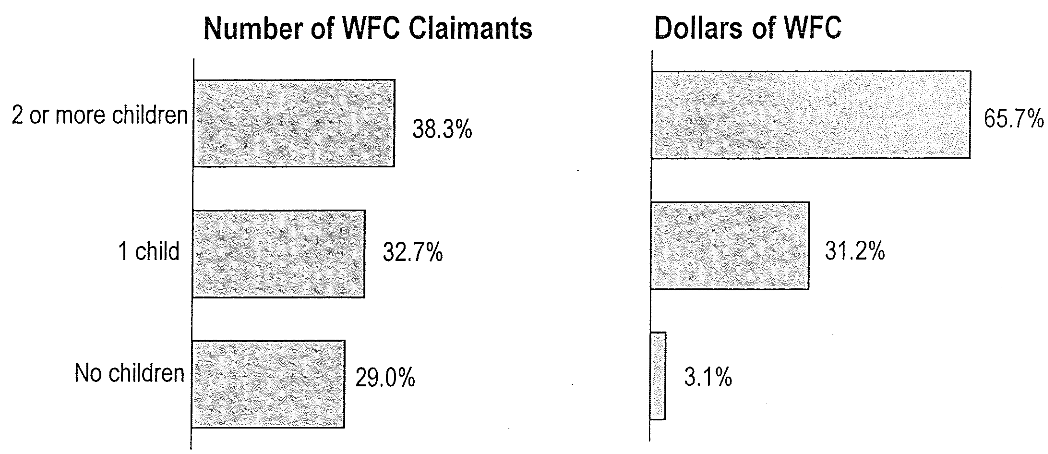
How much is paid out in credits?

In tax year 2011, Minnesotans claimed $696 million in EITC, of which $82 million offset tax liability, and the remaining $614 million was paid as a refund. The average EITC claimed by Minnesotans was $1,955.

Minnesota returns claimed an additional $209 million in WFC, of which $40 million offset tax liability, and the remaining $169 million was paid as a refund. The average WFC was $606.

How are the credits distributed among different types of families?

Seventy-one percent of all working family credits went to families with one or more children. These families received about 97 percent of the total amount of credits paid in 2011. Individuals without children filed 29.0 percent of returns claiming credits, but received only 3.1 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children. The distribution of earned income tax credits is similar.



How are the credits distributed geographically?

Under half (48 percent) of the returns claiming credits came from the Twin Cities metropolitan area, but these seven counties generated about 51 percent of all income tax returns filed. Put another way, in 2011, as in previous years, nonmetro filers were slightly more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 19.1 percent of all income tax returns claimed the EITC, compared to 13.7 percent in Minnesota. The average EITC nationwide in 2011 was $2,252; it was $1,955 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

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

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, March 2013.

Nina Manzi

June 2014

Major State Aids and Taxes: An Overview of the 2010 Update

This provides a brief overview of the report *Major State Aids and Taxes: A Comparative Analysis, 2010 Update*, which highlights major aids provided to the local governments and people in Minnesota and lists the major taxes collected. The per capita amounts were calculated using 2010 population. Some aids are presented on a different basis in other settings (e.g., per pupil for education aid); however, in the report they are presented on a per capita basis to allow comparison of different aids.

STATE AIDS

Program	Year	Amount (millions)	Per Capita
Education aid *Aid paid to school districts for all K-12 educational expenses*	2009/2010 (school year)	**$6,145.2 State** $3,426.9 Metro $2,718.3 Nonmetro	**$1,159 State** $1,203 Metro $1,108 Nonmetro
Human services aid *State's share of human services aid for various income and medical assistance programs*	2010	**$3,606.7 State** $1,971.4 Metro $1,635.3 Nonmetro	**$680 State** $692 Metro $666 Nonmetro
Highway aid *Distributed to counties, cities, and towns for highway purposes*	2010	**$590.8 State** $182.0 Metro $408.7 Nonmetro	**$111 State** $64 Metro $167 Nonmetro
Local government aid *Provides property tax relief by providing general purpose financial support to cities*	2010	**$426.4 State** $133.2 Metro $293.2 Nonmetro	**$80 State** $47 Metro $119 Nonmetro
Disparity reduction aid *Provides aid to jurisdictions (counties, towns, and school districts) that had inordinately high tax rates in 1988*	2010	**$18.0 State** $1.4 Metro $16.7 Nonmetro	**$3 State** – Metro $7 Nonmetro
County program aid *County general purpose aids: includes former homestead and agricultural credit, county criminal justice aid, family preservation aid, and attached machinery aid*	2010	**$164.9 State** $67.0 Metro $97.9 Nonmetro	**$31 State** $24 Metro $40 Nonmetro
Community corrections funding *Aid that provides a portion of counties' costs for community correctional services*	2010	**$84.8 State** $42.2 Metro $42.7 Nonmetro	**$16 State** $15 Metro $17 Nonmetro
Property tax refund (excludes targeting) *Reimburses homeowners and renters for a portion of property taxes if those taxes exceed a household income threshold*	2009 (filed in 2010)	**$411.5 State** $283.1 Metro $128.4 Nonmetro	**$78 State** $99 Metro $53 Nonmetro
Targeting *Additional homeowner property tax refund if property taxes increased a certain percentage threshold over previous year (no income limits)*	2009 (filed in 2010)	**$2.3 State** $1.0 Metro $1.3 Nonmetro	**– State** – Metro $1 Nonmetro

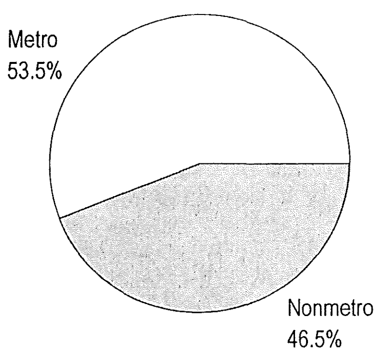
Major Taxes

	Year	Amount (millions)	Per capita
Individual income tax *Imposed on income of state residents and income derived from state sources of nonresidents*	2009 (filed in 2010)	**$6,167.4 Total** **$5,933.3 Residents** $3,935.0 Metro $1,998.2 Nonmetro	**$1,119 State** $1,381 Metro $814 Nonmetro
Sales and use tax *Imposed on gross receipts of people who sell, lease, or rent tangible personal property at retail at a rate of 6.5 percent (does not include local sales taxes)*	2010	**$4,511.9 (After refunds)** **$3,792.8 Residents** $2,438.0 Metro $1,354.9 Nonmetro	**$715 State** $856 Metro $552 Nonmetro
Motor vehicle sales tax *Imposed on new and used motor vehicles at the time of sale at the same rate of state sales tax*	2010	**$468.5 State** $244.2 Metro $224.3 Nonmetro	**$88 State** $86 Metro $91 Nonmetro
Motor vehicle registration tax *Imposed annually on vehicles licensed in the state*	2010	**$539.7 State** $290.7 Metro $249.0 Nonmetro	**$102 State** $102 Metro $101 Nonmetro
Motor vehicle fuels tax (gas tax) *Imposed on gasoline, diesel fuel, and other motor fuels used by vehicles and on aviation fuels*	2010	**$844.4 State** $395.9 Metro $448.6 Nonmetro	**$159 State** $139 Metro $183 Nonmetro
Corporate franchise (income) tax *Imposed at a rate of 9.8 percent on the net income of corporations (or alternative minimum tax)*	2010	**$661.9 State** $479.8 Metro $182.0 Nonmetro	**$125 State** $168 Metro $74 Nonmetro
State general property tax *Imposed on commercial/industrial/public utility property and seasonal recreational property*	2010	**$776.7 State** $520.7 Metro $256.0 Nonmetro	**$146 State** $183 Metro $104 Nonmetro

Property Tax Data

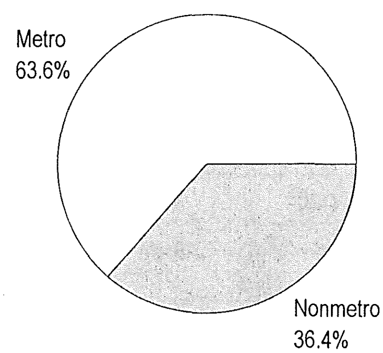
Market Value

Total statewide: $582.5 billion



Net Property Tax

Total statewide: $8.0 billion



For more information: Contact legislative analyst Nina Manzi at 651-296-5204. See *Major State Aids and Taxes: Comparative Analysis, 2010 Update* (June 2014) for further details about each aid program and tax and data by county and economic development region.

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

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HOUSE RESEARCH | Short Subjects

Danyell A. Punelli

June 2014

Nursing Facility Reimbursement

The Medical Assistance (MA) program reimburses nursing facilities for some costs relating to the care of MA patients. The Minnesota Department of Human Services (DHS) administers the MA reimbursement system for nursing facilities and establishes the reimbursement rates for each facility.

For what costs does MA reimburse nursing facilities?

MA reimburses nursing facilities for operating costs, external fixed costs, and property costs.

Operating costs include costs for nursing, social services activities, dietary, housekeeping, laundry, building maintenance, and administration; salaries and wages of persons performing these services; fringe benefits and payroll taxes; and other related costs such as costs for supplies, food, utilities, and consultants.

External fixed costs includes surcharges and fees; scholarships; planned closure rate adjustments; single-bed room incentives; property taxes and property insurance; and Public Employee Retirement Act costs.

Property costs include interest expense and return on equity.

What methods have been used to determine payment rates?

Prior to October 1, 2006, nursing facilities were reimbursed under a cost-based system sometimes referred to as "rule 50," where reimbursement to facilities was based on their reported costs, subject to various limits. From October 1, 2006, through September 30, 2008, all nursing facilities participating in MA were reimbursed under the Alternative Payment System (APS), a contract-based system where facilities were exempt from certain statutory requirements of the cost-based system and reimbursed at the level of their payment rate in effect just prior to entering into an APS contract with the commissioner. Since October 1, 2008, facilities have been reimbursed under a blend of APS and a "rebased" reimbursement rate (see below for more on rebasing).

Are nursing facility rates adjusted for inflation?

Nursing facility rates are supposed to be adjusted annually for inflation. However, effective July 1, 1999, through September 30, 2011, the automatic inflation adjustment was applied only to the property-related rate. Inflation adjustments for operating costs must be authorized by the legislature; the legislature most recently authorized adjustments in 2008, 2013, and 2015. In addition, the 2011 Legislature suspended the automatic inflation of property payment rates for rate years beginning October 1, 2011, and October 1, 2012. The 2013 Legislature suspended the automatic inflation of the operating and property portions of the payment rate for rate years beginning October 1, 2013, through October 1, 2016.

Do nursing facility rates vary by facility?

Reimbursement rates are facility- and resident-specific. Rates vary with the facility's historical costs, with the amount of care needed by a resident (as measured by a case-mix classification), and reflect any statutory facility-specific rate adjustments authorized by the legislature.

What are case-mix classifications?

Nursing facilities are reimbursed by MA on a resident-per-day basis. The nursing home reimbursement levels are adjusted under the Resource Utilization Groups (RUG) case-mix system to reflect the varying care needs of residents.

All applicants to nursing facilities are assessed upon admission and at least every 90 days thereafter and assigned to a case-mix classification based on the level of their dependence in activities of daily living, the severity of their cognitive and/or behavior management needs, and the complexity of their nursing needs. Each case-mix classification is assigned a case-mix weight, with the lowest level of care receiving the lowest weight and the highest level of care receiving the highest weight. Reimbursement for care-related costs for each classification is proportional to the case-mix weight; per-diem reimbursement for nursing care is therefore lowest for the case-mix classification needing the lowest level of care and highest for the case-mix classification needing the highest level of care. Rates are the same for all nondirect care-related components across all RUGs within a facility's rate set.

What is rebasing?

The 2007 Legislature required DHS to rebase nursing facility rates, meaning that operating payment rates for nursing facilities would be calculated using the statistical and cost report filed by each nursing facility for the report period ending one year prior to the rate year. Similar to the APS, these reimbursement rates would vary with resident case-mix and incorporate reimbursement for care-related, other operating, external fixed, and property costs. Rebasing would allow nursing facilities to have new or currently unreimbursed expenditures recognized in the facility payment rate, subject to certain statutory limits.

Rebasing for operating cost payment rates began October 1, 2008, and was designed to be phased in over eight years. During the phase-in period, nursing facilities were to (1) receive a blended rate—based partially on the APS reimbursement system and partially on the new value-based (rebased) reimbursement system; and (2) be held harmless—a facility could not receive an operating cost payment rate that was less than what the facility would have received without rebasing. Property rates will be rebased beginning October 1, 2014.

The 2011 Legislature prohibited all further steps phasing in rebased operating payment rates—leaving nursing facilities with blended operating payment rates. This was projected to save the state in excess of $100 million per year in fiscal years 2014 and 2015. The savings result from cancelling scheduled rate increases.

What other payments do nursing facilities receive?

Nursing facilities may receive several other payments including:

- incentive payments to create single-bed rooms as a result of bed closures and for the planned closure of beds in an area of the state where excess bed capacity exists or where a rebalancing of long-term care services is desired;
- performance-based incentive payments;
- quality add-on payments beginning in fiscal year 2015; and
- partial rebasing and enhancement of certain payments for facilities designated as critical access nursing facilities beginning in fiscal year 2015.

For more information: Contact legislative analyst Danyell A. Punelli at 651-296-5058. Also see the House Research publication *Nursing Facility Reimbursement and Regulation*, October 2013.

Danyell Punelli

Revised: June 2014

Minnesota Family Investment Program

The Minnesota Family Investment Program (MFIP) is a jointly funded, federal-state program that provides income assistance to eligible low-income families. MFIP is the state's response to the 1996 federal welfare reform law, which replaced the Aid to Families with Dependent Children (AFDC) program with Temporary Assistance for Needy Families (TANF), a block grant program to states.

Who is eligible for MFIP?

A family must have income and assets below the program's limits. The income limit increases with family size. Families do not exit MFIP until their income reaches 115 percent of the federal poverty guidelines (FPG). The 2014 FPG for a family of three is $19,790 (115 percent of FPG for a family of three equals $22,760). Assets are limited to $2,000 for MFIP applicants and $5,000 for ongoing recipients, excluding certain items. In addition, families must meet the following eligibility requirements:

- have a minor child in the home (or be pregnant)
- be residents of Minnesota
- be U.S. citizens, qualified noncitizens, or noncitizens otherwise lawfully residing in the United States
- assign rights to child support to the state
- have received fewer than 60 months assistance total from any state
- satisfy any other eligibility requirements of the program

Families are subject to a *lifetime limit of 60 months of assistance*. Some families may be eligible for assistance extensions past the 60-month limit if they meet specific criteria for one of the following extension categories: ill or incapacitated, hard-to-employ, and employed participants.

MFIP participants may be eligible for other benefits such as child care assistance and Medical Assistance.

How much are monthly benefits?

The MFIP grant is based on a transitional standard that increases with family size. For example, a family of three's monthly benefit in 2014 is $978; a family of four's benefit is $1,190. For families without earnings, the monthly grant equals the transitional standard. For families with earnings, the monthly grant equals the "family wage level" (110 percent of the transitional standard minus the family's net earned income). The MFIP grant is composed of a cash portion and a food portion, both of which are issued by counties in electronic debit card form.

What are the work requirements?

MFIP caregivers (i.e., persons who live with and provide care and support to minor children) are required to spend a specified number of hours every week engaged in work or work activities. Examples of acceptable activities include job search activities, unsubsidized employment, and on-the-job training.

Employment plans must be tailored to recognize the special circumstances of MFIP participants who meet certain criteria, such as being over age 60, being ill or incapacitated, caring for a disabled child, or being the victim of family violence.

Participants who are interested in participating in postsecondary education as part of their employment plan must discuss their education plans with their job counselor. Job counselors must work with participants to evaluate options.

Special requirements exist for *caregivers under age 20*. In most cases, education is the first priority for teen MFIP participants.

How do sanctions work?

MFIP participants who do not meet the program requirements may be sanctioned through reduction of their monthly grant. Sanctions last until one month after a participant comes into compliance. An MFIP case must be closed after the seventh occurrence of noncompliance.

What are MFIP's funding streams and expenditures?

MFIP is funded with a combination of federal funds and state appropriations. Minnesota received approximately $268 million annually in TANF block grant funding in federal fiscal years 1998 to 2014 (this amount is subject to federal reauthorization). In addition, federal law includes a maintenance of effort (MOE) provision that requires a state to spend 75 percent to 80 percent of the amount it spent in 1994 under its old AFDC and related programs to assist needy families. In fiscal year 2014 the state's required MOE amount was $176.7 million per year. The MOE requirement is met through state spending on programs such as MFIP, child care assistance, and the working family tax credit. TANF is used for MFIP and a variety of other programs that assist low-income families.

According to the Department of Human Services, for state fiscal year 2013, total expenditures were $149.4 million for the cash portion and $159.6 million for the food portion of the MFIP grants. In terms of funding, $66.3 million was financed with federal TANF funds, $158.9 million was from federal Supplemental Nutrition Assistance Program funds, and $83.8 million was from state appropriations.

How many families receive MFIP?

In fiscal year 2014, in an average month an estimated 33,823 families and a total of 90,248 participants were receiving MFIP assistance.

For more information: See the House Research publication *Minnesota Family Assistance*, November 2012, and the following Short Subjects: *Minnesota Family Investment Program Time Limit Exemptions and Extensions,* July 2004, and *MFIP Cases Reaching the 60-Month Time Limit,* July 2013.

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HOUSE RESEARCH | Short Subjects

Danyell Punelli

Updated: June 2014

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 2014, 47 percent of state median income was $34,459, and 67 percent of state median income was $49,123 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 2013, there were an average of 1.87 children per family receiving MFIP child care assistance and 1.80 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 2013, the estimated average annual subsidy for a family receiving MFIP child care assistance was $13,402, and the estimated average annual subsidy for a family receiving BSF child care assistance was $9,731.

Prior to 2003, there was a statutory mechanism in place to regularly increase provider reimbursement rates based on a survey of rates. Beginning in 2003, reimbursement rates were frozen for several years. Now, maximum reimbursement rates paid for child care assistance are set by the legislature. The 2011 Legislature decreased provider reimbursement rates by 2.5 percent, effective October 31, 2011. The 2013 Legislature modified reimbursement rates effective February 3, 2014, and created a provider rate differential for child care providers that hold a three- or four-star quality rating under the Parent Aware quality improvement and rating system.

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 ($14,843 and below for a family of three in 2014).
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. Total estimated fiscal year 2014 annual direct service payments are $122.6 million for MFIP and transition year child care and $99.0 million for BSF child care assistance.
How many families receive child care assistance?	During fiscal year 2013, an estimated average of 8,389 families received MFIP child care assistance and 8,609 families received BSF child care assistance per month. Not all families who apply for child care assistance receive it. MFIP child care is a forecasted, fully funded program, while BSF child care receives a capped allocation. As of March 31, 2014, there were 7,741 families on the waiting list for BSF child care assistance.
What is the child care quality rating system?	Minnesota has a voluntary child care and early learning program quality rating system called Parent Aware. The rating system is currently only available in certain areas of the state, but will be available to parents and providers statewide by 2015.
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 county or region.

For more information: See the House Research publications *Funding to Support Child Care Assistance*, December 2011, and *Minnesota Family Assistance*, November 2012.

Lisa Larson

Revised: May 2014

Minnesota's New High School Assessments

The 2013 Legislature enacted a new testing law that changes the requirements for students to graduate from high school (Laws 2013, ch. 116). The new assessments focus on math, reading and writing, and career expectations and college readiness. In addition to changing future testing requirements, the law also allows students who previously did not pass a "high stakes" test to take an alternate assessment in order to graduate.

Students who meet credit requirements but did not pass a "high stakes" test can take an alternate assessment and graduate from high school

Under the new state testing law, students in grade 8 in any school year through the 2011-2012 school year who met state and district credit requirements but did not pass the Minnesota Comprehensive Assessment (MCA), Graduation-Required Assessments for Diploma (GRAD), or basic skills tests can take an alternate assessment and still graduate from high school. These students no longer need to pass the grade 9 writing GRAD test, the grade 10 reading MCA or GRAD test, or the grade 11 math MCA or GRAD test. The alternate assessments include the following:

- the WorkKeys jobs skills assessment
- the Compass college placement test
- the ACT assessment for college admission
- a nationally recognized armed services vocational aptitude test
- an alternative, equivalent assessment

Students who choose to retake an MCA/GRAD test must pass it (a student who did not pass and was not required to pass the math GRAD test under a 2009 waiver need not retake the test).

No specified score, level of proficiency is required

Students are not required to achieve a specified score or level of proficiency on any of the alternate assessments in order to graduate from high school or on any of the new assessments that apply to students in grade 8 beginning in the 2012-2013 school year and later.

Students are subject to new career and college readiness assessments

Students in grade 8 in the 2012-2013 school year and thereafter are subject to new assessments, premised on expectations for careers and college readiness. These expectations are based on a continuum of empirically derived, clearly defined career and college-ready benchmarks. These benchmarks let students, parents, and teachers know how well students must perform to have a reasonable chance to succeed in a career or college without need for postsecondary remediation.

The education commissioner, after consulting with local school officials, educators, and Minnesota's public postsecondary institutions, identified the foundational knowledge and skills students need for career and college readiness, and targeted interventions to help students who are not yet ready. The commissioner then contracted for the assessments through a request for proposal process.

Minnesota's new suite of assessments include career exploration and planning; math, reading, and writing tests; and college placement and entrance exams

The requirements for the new suite of assessments include the following:

- **Career exploration and planning:** Beginning no later than grade 9, students undergo a career exploration assessment based on a student's interests, aptitudes, and aspirations. The transition plan helps students and their families explore career options and postsecondary education leading to an industry-recognized credential, an associate's degree, or a bachelor's degree.
- **Math, reading, and writing tests:** Students in grades 8 and 10 take math, reading, and writing Explore and Plan tests in the fall that are predicative of a nationally normed assessment for career and college readiness. The tests will be used to monitor students' continuous development of and growth in acquiring requisite knowledge and skills and to analyze students' academic progress and performance levels.
- **College placement exam:** Students in grades 10 and 11 take the Compass, a college placement diagnostic exam, if they have shown that they are not yet ready for a career or college, based on their growth in academic achievement between grades 8 and 10. Results of the exam will be used to diagnose areas where students need curriculum or instructional adjustments, targeted interventions, or remediation; identify the instructional tools and best practices needed to support students; and improve students' knowledge and skills so they can graduate and have a reasonable chance to succeed in a career or college without remediation. Students may participate in targeted instruction, intervention, or remediation through grade 12.
- **College entrance exam:** All students in grade 11 must take the ACT Plus Writing college entrance exam. Students in grades 11 and 12 who demonstrate attainment of required state academic standards and career and college readiness benchmarks are encouraged to participate in courses for college credit, including sequential courses of study within career areas.

Eligible students take an alternative assessment

Students with an individualized education program may satisfy state assessment requirements by achieving an individual score on state-identified alternative assessments.

Adult basic education students must be informed about targeted interventions

The education commissioner and the chancellor of the Minnesota State Colleges and Universities must collaborate in aligning instruction and assessments to give adult basic education students diagnostic information about the targeted interventions they need to seek postsecondary education or employment without need for postsecondary remediation.

Students must continue to take reading and math MCAs

Students will continue to take the grade 10 reading MCA, grade 11 math MCA, and science tests in grades 5, 8, and high school to meet federal testing requirements under the No Child Left Behind Act. However, the education commissioner must determine the alignment of the new suite of assessments and state academic standards and, to the extent alignment exists, the commissioner must immediately seek federal approval to replace the reading and math MCAs with these new assessments.

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

Matt Gehring **Updated: May 2014**

Campaign Finance and Public Disclosure Board Appointments

The Campaign Finance and Public Disclosure Board oversees Minnesota's laws on campaign finance and disclosure, lobbyist reporting, economic interest statements, and conflicts of interest. These laws generally apply to state and certain local public officials, candidates for state offices, organizations engaged in campaign activity, and individuals employed to lobby the legislature, an administrative agency, or certain local governments on behalf of a client or principal association.

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.

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.

Historically, the committees of the House of Representatives and the Senate with responsibility for elections have conducted public hearings to review the qualifications of each nominee and recommend whether the nomination should be confirmed.

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:

- 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

Joel Michael

Updated: June 2014

Tax Increment Financing

What is TIF?

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

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

How does TIF work?

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

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

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

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

What governmental units can use TIF?

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

What is the but-for test?

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

What types of TIF districts may be created?

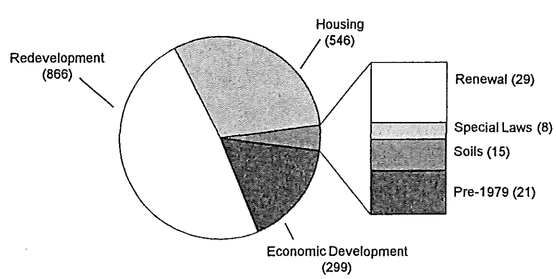
Minnesota allows several different types of TIF districts. The legal restrictions on how long increments may be collected, the sites that qualify, and the purposes for which increments may be used vary with the type of district.

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

How many TIF districts exist?

According to the 2014 report of the Office of State Auditor (OSA), there were 1,784 active TIF districts in 2012. The graph shows the relative shares by type of district.

TIF Districts by Type in 2012
(1,784 districts)



Source: 2014 Report of the State Auditor

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

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: June 2014

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 by the state and affect the incidence and competitiveness of the tax. Most states use a three-factor formula based on the in-state percentage of the corporation's sales, payroll, and property factors. Traditionally and under the Uniform Division of Income for Tax Purposes Act, each factor was equally weighted. However, the states have tended recently to increase the weight to the sales factor and more states are relying only on the sale factor ("single sales apportionment").

Minnesota uses single sales apportionment

Since 1940, Minnesota has provided for sales-weighted apportionment (70 percent sales), and between tax years 2007 and 2014, phased in single sales apportionment. (Minnesota's original weighted apportionment was optional; it became mandatory in tax year 1988.)

Effects vary by type of business

The effects of 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 are unaffected—all of their income is subject to tax in all cases.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors receive a tax cut. The larger the disparity, the bigger the benefit. 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 pay higher tax.

"Throwback rules" affect the benefit to taxpayers of single sales apportionment

Over half of the states with corporate taxes also use "throwback rules" in defining the sales factor. Throwback rules treat sales to out-of-state buyers as in-state sales, if the buyer's state cannot tax the business/seller or if the purchaser is a federal government agency. These "thrown-back" sales increase in-state sales factor and corporate tax, decreasing the benefits to the taxpayer of single sales apportionment. Minnesota does not have a throwback rule.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is a competitiveness argument: It helps attract or retain investment in plant and equipment to the state. 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, single sales apportionment 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 their products outside of

Minnesota. Empirical studies have found some support for this argument.

Policy concerns with single sales apportionment: equity and tax theory

Opponents of single sales apportionment argue that it shifts the tax burden from capital (the property factor) to consumption, reducing the tax's progressivity. 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. Both factors contribute to the production of income and the consumption of government services.

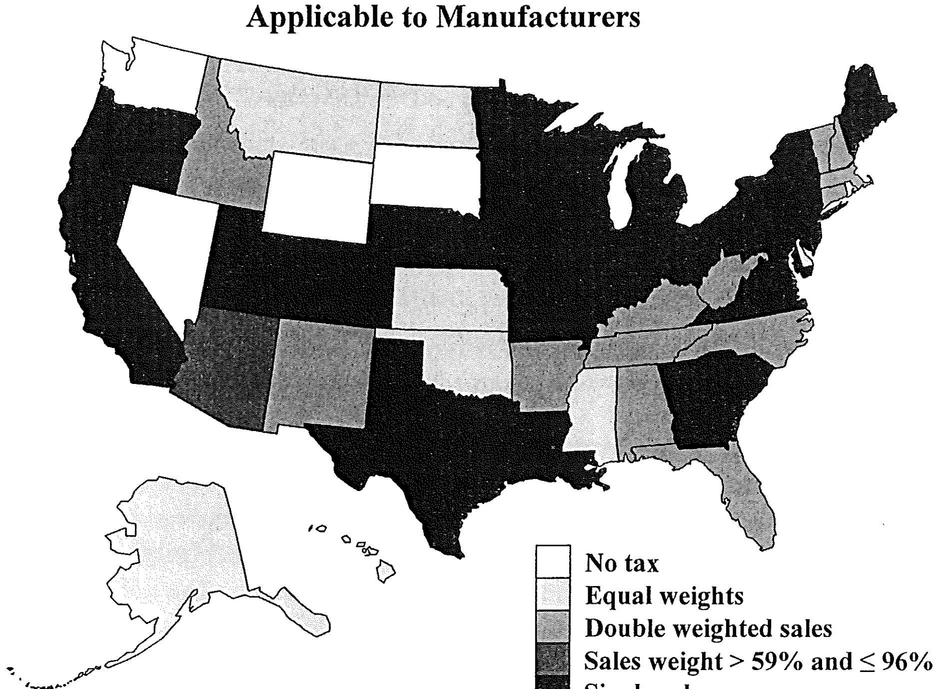
Sales-weighted apportionment reduces revenues

Compared with equally weighting each apportionment factor, weighting sales more heavily reduces tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2014) shows an expenditure cost of $390 million for fiscal year 2015.

Trend in other states to heavier sales weighting

Effective for tax year 2014, 23 states use or allow single sales as their apportionment formula for manufacturers. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Indiana, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. Rhode Island is also scheduled to use single sales in 2015, Arizona in 2017, and New Mexico in 2018. The map below shows the apportionment formulas for manufacturers as of tax year 2014. 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 joel.michael@house.mn. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, July 2013.

Lisa Larson

Updated: June 2014

State Laws on Teacher Quality and Effectiveness

At least five areas of teacher quality and effectiveness are currently prescribed in state statute or rule: teacher education and preparation, licensure, development and accountability, compensation, and certification.

The Minnesota Board of Teaching approves teacher preparation programs and institutions

The Minnesota Board of Teaching approves Minnesota colleges and universities and their teacher preparation programs. Individuals who complete board-approved teacher preparation programs can be recommended for a teaching licensure. The board evaluates and approves teacher preparation institutions and programs at least once every seven years. The board may grant approval of an institution, grant conditional approval pending the institution meeting stated conditions, and revoke or suspend an institution or preparation program that does not meet the requirements in rule. The board also may grant five-year approval of experimental teacher preparation programs that meet certain criteria.

The standards the board uses to evaluate teacher preparation institutions and programs are similar to the standards that the National Association for Colleges of Teacher Education (NCATE) uses to accredit teacher preparation institutions and programs. The board also approves individual licensure programs, such as elementary or math education.

Teachers must satisfy teacher preparation and continuing education requirements

A traditional teacher candidate must complete a board-approved teacher preparation program (including student teaching), pass reading, writing, and math skills exams or attain an equivalent composite score on the ACT Plus Writing or the SAT, and pass exams of general pedagogical knowledge and licensure-specific teaching skills to receive a teaching license. A candidate who completes a teacher preparation program in another state may be eligible for a teaching license. The board issues licenses for specific circumstances, including a nonrenewable license, a temporary limited license, and a short-call (or short-term) substitute teacher license.

A teacher must complete 125 clock hours of continuing education in order to renew a five-year professional license for another five-year period. Continuing education must include preparation in the key warning signs of early-onset mental illness in children and adolescents, further reading preparation, use of positive behavior interventions, use of technology, further preparation in English language development and content instruction for English learners, and evidence of work that demonstrates professional reflection and growth in best teaching practices. The board may grant variances to its licensure rules.

New teachers must complete a probationary period

Two statutes govern conditions of continuing employment for licensed teachers: Minnesota Statutes, section 122A.40 applies to teachers in public schools generally; and Minnesota Statutes, section 122A.41 applies to teachers in the Minneapolis, St. Paul, Rochester, and Duluth school districts. A newly licensed probationary teacher must successfully complete three years of continuous employment before becoming a continuing contract or tenured teacher. A probationary teacher may interrupt the probationary period for maternity, paternity, or medical leave. During the probationary period, a school board must formally evaluate probationary teachers, but the standards for the evaluations are not specified and the school board has considerable discretion in deciding whether to renew the probationary teacher's employment contract.

Continuing contract and tenured teachers are entitled to employment-related protections

Once a teacher receives a continuing contract or tenure, the teacher is entitled to employment-related protections, including bumping rights and just cause and due process guarantees. The terms "continuing contract rights" and "tenure rights" mean that a district may not dismiss a teacher without cause. These terms offer equivalent procedural protections and are often used interchangeably. The laws require mentoring for probationary teachers and peer coaching for continuing contract teachers but do not specify the standards or frequency for these activities. The continuing contracts of teachers in nonfirst-class city school districts remain in full force and effect unless a circumstance leads the school board to terminate the teacher. Tenured teachers in first-class city school districts may be discharged or demoted under specified circumstances.

Districts must implement a three-year local or state process to develop and evaluate teachers

Beginning in the 2014-2015 school year, local school boards and the exclusive representative of the teachers must either agree to a three-year process to develop, review, and evaluate teachers or implement the state teacher evaluation and peer review process. For the first two years, a tenured teacher must have professional development opportunities and be reviewed by peers. During the third year, a trained and qualified evaluator such as a school administrator must undertake a summative evaluation of the teacher.

Q-Comp is a voluntary teacher advancement and compensation program

Q-Comp is a voluntary alternative teacher professional pay system, which allows interested districts, school sites, and charter schools and their teachers to develop and implement a professional teacher development and compensation plan specific to local needs. All Q-Comp plans contain five components: career advancement options; job-embedded professional development; an objective teacher evaluation plan aligned with the local staff development plan; performance pay that bases at least 60 percent of compensation increases for teacher performance on schoolwide student achievement gains and individual teacher evaluations; and an alternative salary schedule that is reflected in the local collective bargaining agreement and requires a "reformed" steps-and-lanes salary schedule. Receipt of Q-Comp funds is contingent upon state Department of Education (MDE) approval of a Q-Comp plan and the availability of Q-Comp funds.

Teachers can also be nationally certified

The National Board for Professional Teaching Standards has developed professional standards for what K-12 classroom teachers should know and be able to do. The board devised an assessment system and a voluntary certification process by which teachers can be certified in 24 fields and developmental levels of instruction. National board certification impacts several teacher licensure rules related to issuing licenses and fulfilling clock hour requirements.

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

Lisa Larson June 2014

Federal Accountability and the No Child Left Behind Act Waiver

The No Child Left Behind Act seeks to improve the education outcomes of disadvantaged students

The 2001 No Child Left Behind Act (NCLB) is the federal law that seeks to ensure that all students and specific subgroups of students achieve state reading and math proficiency by 2014. NCLB school improvement requirements apply to high-poverty schools receiving federal Title I funds. The act imposes increasingly severe consequences and redirects the resources of those Title I schools that fail to sufficiently improve students' reading and math proficiency according to a time line. The act also focuses attention on the poor educational outcomes of disadvantaged students.

States were granted federal waivers in exchange for implementing specific reforms

The U.S. Congress has not yet amended and reauthorized the act, which was anticipated to be reauthorized in 2007. In the meantime, and because the need to improve school effectiveness remains, the U.S. Secretary of Education offered to waive certain federal requirements for states, including Minnesota, if those states agreed to implement specific federal reforms.

In 2012, Minnesota was granted a two-year waiver after it agreed to implement the following federal reforms:

- implementing college and career-readiness standards and assessments to measure student achievement and growth
- recognizing high-achieving and high-growth schools and supporting chronically low-achieving schools
- using teacher and principal evaluation and support systems to improve instruction
- reducing duplication and other similar burdens

In exchange for implementing the federal reforms, Minnesota schools do not need to provide supplemental education or transportation services for intradistrict transfers, are not sanctioned for failing to make adequate yearly progress (AYP), and have greater flexibility in allocating Title I funds. The state's NCLB waiver was extended through the 2015-2016 school year.

Minnesota's waiver uses a multiple measures rating (MMR) to focus on the academic achievement gap

Minnesota's waiver replaces the original NCLB goal of achieving 100 percent student proficiency in reading and math by 2014 with a goal of reducing Minnesota's student achievement gap between all students and certain historically underperforming groups of students by 50 percent by 2017. The waiver also replaces the federal AYP measure with an annual multiple measures rating (MMR), based on student academic proficiency and growth measures, school success in reducing the achievement gap for specific student groups, and student graduation rates. The federal MMR measures are distinct from the educational accountability measures—coursework completion, rigorous course taking, student engagement and connection at school—found in Minnesota Statutes.

MMR divides student test data into four proficiency categories

Under the waiver, the MMR ratings divide students' performance on statewide tests into four proficiency categories: does not meet, partially meets, meets, and exceeds standards. Statewide reading and math proficiency targets are set for all students and particular student groups: American Indian; Asian; Hispanic; Black; White; limited English proficiency; special education; and free and reduced price lunch. A school's **proficiency index** is determined by comparing the performance of particular student groups within a school to the established statewide proficiency target for that student group. A school earns points based on the ability of student groups within the school to meet reading and math proficiency targets.

The MMR academic growth score compares students' actual and expected test scores

To determine a school's focus rating, students receive an **academic growth score** based on a comparison between students' actual and expected test scores in reading and math. Students are expected to meet or exceed their expected score, which is based on their test score in the previous school year. Students' individual growth scores in a school are averaged to determine a school growth score. A school earns points based on its success in accelerating students' academic growth.

The MMR focus rating measures a school's ability to close growth and achievement gaps among typically low-performing student groups

The **achievement gap measure** looks at schools' success in accelerating the academic growth for seven typically low-performing student groups: Black; Hispanic; Asian; American Indian; free and reduced price lunch (FRP); limited English proficiency (LEP); and special education. The academic growth for each student group at the school is compared to the statewide average for that student group. The academic growth for the four student groups of color is compared to the statewide average for white students. The academic growth of the three remaining student groups (FRP, LEP, special education) is compared to the statewide average for all students not included in the particular student group. A school earns points based on its success in accelerating the academic growth of these student groups and thereby closing the academic achievement gap among student groups.

The MMR 90 percent graduation rate is the target for all students

The **graduation rate** for all student groups within a school with at least 40 students is compared to a 90 percent high school graduation rate target for all students and particular student groups. A school earns points by demonstrating its ability to meet the 90 percent target graduation rate or by annually improving its graduation rate.

Minnesota must continue to implement specific reforms under its extended waiver

Minnesota applied to renew its federal waiver in February 2014. The extended waiver requires Minnesota to continue to implement specific testing, accountability, and school improvement reforms including, among other items, career and college-ready standards by the 2013-2014 school year, teacher and principal evaluation and support systems by the 2014-2015 school year, and interventions aligned with turnaround principles for schools in the bottom 5 percent of most persistently low-performing schools. If the U.S. Congress reauthorizes NCLB before the waiver period ends, the reauthorization may affect the status of Minnesota's waiver.

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

Joel Michael and Nina Manzi

Updated: June 2014

Minnesota Angel Investment Credit

What is the angel investment credit?

The Minnesota Small Business Investment Credit (commonly referred to as the angel investment credit) provides qualified investors in certified small businesses with a refundable income tax credit equal to 25 percent of their investments up to a maximum of $125,000 ($250,000 for married joint filers). The maximum credits for investments in a business cannot exceed $1 million. The credit took effect for tax year 2010 and expires for investments made after tax year 2016.

Three key sets of requirements apply under the credit:

- Rules that govern which investors qualify to make investments
- Rules specifying the types of businesses that qualify to receive investments
- Limits on which investments qualify

What investors qualify for the credit?

The angel credit allows two different types of investors to qualify for the credit:

- **Individual investors** qualify either by being accredited investors under Securities and Exchange Commission Regulation D or by certifying that they will only invest in an offering that is exempt from registration under state law. Accredited investors must have net worth of at least $1 million (excluding the value of their homes) or annual income of at least $200,000 ($300,000 for married couples). Beginning in tax year 2015, individuals who are officers of or who in combination with their family members own or control 20 percent or more of the business cannot claim the credit.
- **Qualified funds** are pass-through tax entities, such as LLCs or S corporations that invest in qualifying small businesses and have three or more investors who each meet the requirements for individual investors. These funds pass through the credit to their individual owners, who claim it on their own tax returns.

Investors must apply to and be certified by the Department of Employment and Economic Development (DEED) before making the investment for which they are claiming the credit. However, individuals who are not accredited investors but who qualify because the offering is a small corporation exempt from registration may apply up to 30 days after making the investment.

What small businesses qualify under the credit?

The credit only applies to investments in a small business that DEED certifies:

- Has its headquarters and 51 percent of its employees and payroll in Minnesota;
- Is engaged in a specified field of business involving proprietary technology or product;
- Has fewer than 25 employees;
- Pays most of its employees wages equal to at least 175 percent of the federal poverty guideline for a family of four;
- Has not been in operation for more than ten years (20 years for businesses

developing drugs or medical devices that require FDA approval); and

- Has not received more than $2 million in private equity investment.

What types of investments qualify for the credit?

To qualify for the credit, an investment must:

- Receive DEED credit certification from the annual credit cap;
- Be made in cash;
- Satisfy minimums of either $10,000 (individuals) or $30,000 (fund); and
- Receive in return an equity-type interest (e.g., common stock, partnership interest, preferred stock, or debt with a mandatory conversion to equity).

How much will the credit reduce state tax revenues?

The law imposes an annual dollar limit or cap on the total amount of credits. The Department of Revenue has estimated that credits will be claimed up to the full amount of the limits. Some of these credits may be paid as refunds (rather than reducing tax liability), since the credit is refundable. The total limit over the life of the credit is $91.9 million:

- $11 million for tax year 2010
- $12 million per year for tax years 2011 through 2013, except the 2013 amount is reduced by $100,000 to fund a program evaluation
- $15 million per year for tax years 2014 through 2016

DEED administers the limits by certifying dollar amounts of credits to applicant investors on a first-come, first-served basis.

Has the demand for credits exceeded the limits?

Applications for tax years 2011 through 2014 used up the full allocations and amount carried over before the end of the year, requiring DEED to reject applicants in all three years.

How many businesses and individuals benefited from the credits?

The table shows the number of investors (including those investing in funds) and businesses for 2010 through 2013.

Calendar year:	2010	2011	2012	2013
Number of businesses	67	113	117	128
Number in metro area	62	102	109	122
Percentage of $ in metro area	94%	80%	95%	95%
Number of investors	267	758	656	651

For tax years 2015 and 2016, $7.5 million is reserved for investments in Greater Minnesota and in women- and minority-owned businesses; any reserved amounts not allocated by September 30 become available for other qualifying investments.

Do clawback provisions apply?

The law provides for revocation and repayment of the credit if the small business does not maintain at least 51 percent of its employees and payroll in Minnesota for five years starting the year after the investment was made. The required repayment declines by 20 percentage points per year (100 percent in year one, 80 percent in year two, etc.). The business, not the investors, must make the repayment.
In addition, investors or funds that do not maintain their investment in the small business for at least three years must repay the credit.

What reporting requirements apply?

Investors, funds, and small businesses must annually report to DEED on their compliance with the law. DEED annually reports to the legislature.

For more information: See the DEED website: http://www.positivelyminnesota.com/Business/Financing_a_Business/DEED_Business_Finance_Programs/Tax_Credits/Angel_Tax_Credit.aspx.

Lisa Larson

June 2014

World Language Proficiency for High School Students

Districts must establish world language standards and offer elective language courses

Minnesota's high school graduation requirements include a minimum of seven elective credits, which may include world language elective credits. Districts must establish standards in world languages and offer elective courses in this subject area. In addition to awarding course credit, schools may recognize students' proficiency in world languages, through language proficiency certificates and bilingual and multilingual seals under Minnesota Statutes, section 120B.022.

Schools may award proficiency certificates to students who demonstrate world language skills

Minnesota public, charter, and nonpublic schools currently may award two types of Minnesota world language proficiency certificates to students who demonstrate listening, speaking, reading, and writing skills in a world language:

- The **Minnesota World Language Proficiency Certificate** recognizes students who have an intermediate-low proficiency level on a valid and reliable assessment. For U.S. Foreign Service Institute "category 3" or U.S. Defense Institute "category 4" world languages with sometimes significant linguistic or cultural differences from English, students must demonstrate an intermediate-low proficiency level for listening and speaking, and a novice-high proficiency level for reading and writing.
- The **Minnesota World Language Proficiency High Achievement Certificate** recognizes students who demonstrate a pre-advanced proficiency level on a valid and reliable assessment. In order to receive a proficiency high achievement certificate for world languages with sometimes significant linguistic or cultural differences from English, students must demonstrate a pre-advanced proficiency level for listening and speaking and an intermediate-mid proficiency level for reading and writing.

American sign language is recognized as a world language for purposes of both types of certificates.

Graduates who demonstrate proficiency in a world language may receive a state bilingual or multilingual seal and school credits

Beginning in the 2014-2015 school year, Minnesota public schools, including charter schools, may award bilingual seals or multilingual seals to high school graduates. To receive a bilingual seal or multilingual seal a student must:

- demonstrate a level 3 functional native proficiency in listening, speaking, reading, and writing in one or more languages other than English on either a Foreign Services Institute language proficiency test or an equivalent assessment;
- complete all English language arts credits required for graduation; and
- demonstrate mastery of Minnesota's English language proficiency standards, if the student's primary language is not English.

A student who demonstrates a level 3 functional native proficiency in one language other than English is eligible to receive the state bilingual seal, and a student who demonstrates a level 3 functional native proficiency in multiple languages other than English is eligible to receive the state multilingual seal. American sign language is recognized as a world language for purposes of these seals. School officials must affix seals to graduates' high school transcripts and may affix seals to the graduates' diplomas. Schools must not charge students a fee for the seals.

In addition to receiving seals, schools may award elective world language credits to students who demonstrate level 3 functional native proficiency in a language other than English and also may award community service credit if these students participate in teacher-directed, curriculum-related activities that support school or community bi-literacy.

Participating public schools must allow students to periodically demonstrate their world language proficiency. The education commissioner must identify and list assessments equivalent to the Foreign Services Institute language proficiency tests on a department Web page and provide for the electronic delivery of the seals. Where valid and reliable assessments are unavailable, schools may use licensed foreign language immersion teachers or qualified nonlicensed community experts to assess students' world language proficiency. Schools must keep appropriate records to identify high school graduates eligible to receive these seals.

MnSCU must award foreign language credits to students with bilingual or multilingual seals

MnSCU colleges and universities must award foreign language credits to students who receive bilingual or multilingual seals and may award foreign language credits to students who receive world language proficiency or world language proficiency high achievement certificates. The MnSCU chancellor and the education commissioner, after consulting with University of Minnesota world language faculty, must determine credit and course equivalencies for each seal and certificate by February 15, 2015.

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

Joel Michael

Updated: July 2014

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.

Legislation in 2014 increased the exemption amount in steps to $2 million by 2018 (*see box*) and provided that calculation of the tax would be based on a state tax rate schedule, rather than the state credit under prior federal law. Rates under the tax range from 9 percent to 16 percent for 2014 deaths (the bottom rate rises to 10 percent in 2015). The top rate applies to the amount of the taxable estate over $10,100,000. The 2014 legislation modifies the rate structure each year as the exemption amount increases so that the increases will largely benefit lower valued estates.

Exemption Amount

The exemption amount is $1.2 million for 2014 deaths. The exemption amount increases by $200,000 per year until it reaches $2 million in 2018. Because transfers to surviving spouses are exempt, a married couple can exempt joint net worth of twice the exemption amount ($2.4 million in 2014) if they structure transfers to trusts appropriately.

Gifts made within three years of death are included in the estate

The 2013 Legislature enacted a gift tax to complement the estate tax. This legislation also subjected gifts made within three years of death to the estate tax; this rule only applies to gifts that are subject to the federal gift tax (i.e., that are above the annual per-recipient exemption, currently $14,000 indexed for inflation). The 2014 Legislature repealed the gift tax, but the three-year rule remains in effect, subjecting these gifts to the estate tax.

An exclusion for qualifying small business property and homestead farmland applies

Legislation passed in 2011 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 and general exemption amount cannot exceed $5 million. As the general exemption increases under the 2014 law, the maximum amount of these special exemptions decline (i.e., the $5 million maximum continues to apply).

The decedent or spouse must have owned the qualifying property for three years before the date of death, and the heirs must own and use the property in the business (or as a farm homestead) 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.

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. The Department of Revenue (DOR) estimates that the 2014 increases in the exemption amount, when fully phased in, will reduce the number of estates subject to tax by almost 37 percent.

Based on DOR's *Tax Incidence Study*, the tax is the most "progressive" state tax. Decedents with taxable estates are some of the most affluent individuals in the state. Most evidence also suggests that recipients of bequests from taxable estates have above-average income and assets.

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

Revenues from the tax are deposited in the general fund. *See the box for the last five years of collections.* Revenues from the tax are volatile, since they depend on the deaths of a few individuals. If one very wealthy individual dies, collections can soar. In other years, revenues may fall below estimates. For example in August 2005, DOR received tax revenues of $112 million from one estate, while total collections were $73 million in the prior year.

Estate Tax Revenues FY 2009-2013 (thousands)	
2009	$130,196
2010	$148,977
2011	$161,202
2012	$165,277
2013	$158,928

Source: Minnesota Dept. of Revenue

DOR estimates that the 2014 increases in the exemption amount and new rate structure will reduce fiscal year 2017 revenues by about $64 million, reducing the tax's revenues by almost 30 percent.

State estate taxes create incentives for high net worth individuals to move to no-tax states

For many years (1985-2001), Minnesota imposed a "pickup" estate tax equal to the now-repealed federal credit for state death taxes. Under this system, the federal treasury bore the effective burden of the tax—the state tax reduced federal tax dollar-for-dollar. As a result, Minnesota residents had no reason to move to another state to avoid the tax. However, with the 2001 repeal of the federal credit in 2001, the state tax became a "real" tax that reduces the amount of property that can be left to heirs.

Avoiding the tax requires changing one's permanent home (domicile) to another state or reducing the amount of Minnesota property owned. 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 (31 in 2014) do not have estate or inheritance taxes. Several of these states also have no income tax, allowing individuals who change their domiciles to those states to avoid both taxes.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research short subject *Estate and Inheritance Taxation: An Overview of the States,* July 2014 and Minnesota Department of Revenue, *Minnesota Estate Tax Study* (2014) for more detailed information.

HOUSE RESEARCH | **Short Subjects**

Joel Michael

Updated: July 2014

Minnesota Research and Development Tax Credit

What is the Minnesota research and development credit?

Minnesota allows businesses conducting research and development to claim research credits against their corporate franchise taxes or individual income taxes (for pass-through tax entities, such as LLCs and S corporations). The credit's computations are based on definitions under the federal tax credit for increasing research activities, except the research must be done in Minnesota.

What is the policy rationale for the research credit?

There are two basic rationales for research credits:

- It is widely recognized that businesses under-invest in research and development, because some of benefits of research go to society generally and cannot be captured solely for the business and its owners. Others can copy or build on their research, siphoning off some of the benefit. Research credits, including the federal and Minnesota credits, are intended to help overcome this barrier by compensating for it and by providing incentives to do qualifying research.

- State credits, such as Minnesota's, have a general "economic development" purpose—that is, they also seek to encourage businesses to do more research in Minnesota to create jobs and other economic benefits for Minnesota residents. The credits help the state to compete for research investment by businesses. Some published academic research supports the view that state credits help to achieve this end.

What types of research expenses qualify?

Under the federal definition used by Minnesota, "qualifying research expenses" must be made to discover technological information that is applied to develop a new or improved business component (e.g., a product or process). The expenditures could be intended to improve quality, performance, reliability or similar. The expenditures typically are for wages of the business's employees, supplies purchased, or amounts paid to contractors to do research for the business. Expenditures on equipment do not qualify, but instead qualify for separate expensing benefits under federal and state tax law.

Is the credit incremental?

The credit applies to research over a base amount. The federal definition of "qualified research expenses" is limited to the *increase* in research expenditures over a "base amount," making the credit an "incremental" credit. This base amount is expressed as a percentage of the business's gross receipts (Minnesota gross receipts for the Minnesota credit). The percentage is determined for each business based on the percentage its research spending was of its 1984-1988 gross receipts (for the businesses starting up after 1988, 3 percent is used) with a maximum of 16 percent. This incremental credit structure is intended to make the credit more cost effective in stimulating research by disallowing the credit for the normal or basic research the business would otherwise do. For example, a business whose research is a constant percentage of its gross receipts would not be allowed the credit, because it had not increased its research "effort."

50-percent limit applies. The credit cannot exceed 50 percent of the business's research expenditures and many businesses' credits are determined under that rule, because their research is always well above their base amount. This typically occurs for Minnesota-based multistate businesses, because their base amounts are calculated using Minnesota gross receipts, a relatively low amount, while their Minnesota research often relates to their entire operations. Since these businesses qualify for a credit based on 50 percent of their research spending, their credits are really not incremental or dependent on increasing the relative amount of their research.

How is the credit computed?

The Minnesota credit has a two-tiered rate structure; a higher rate (10 percent) applies to the first $2 million of Minnesota qualified research expenses and a lower rate (2.5 percent) for the amount over that.

Is the credit refundable?

The credit is not refundable; it cannot exceed the liability for tax. (For three tax years, 2010 through 2012, the credit was refundable.) However, a unitary business (that is, a business with two or more corporations or other entities that are part of one business), may allocate the credit among its individual corporations to fully use the credit. If the credit still exceeds the liability for tax, it can be carried over and used to reduce taxes in later tax years (for up to 15 tax years).

How much does the credit reduce tax revenues?

The Minnesota Department of Revenue's (DOR) *Tax Expenditure Budget* (February 2014) estimated that for fiscal year 2015, $44.5 million in corporate franchise tax credits will be allowed and $13.8 million in individual income tax credits.

How does Minnesota's credit compare to credits in other states?

Minnesota was the first state to enact a research and development credit in 1981. Most states with corporate taxes now have credits for some types of research expenditures. These credits vary considerably and it is difficult to generalize about them. Some states, like Minnesota, follow the basic federal credit. Other states use different—both more expansive or narrower—definitions of the types of research that qualify for their credits. Some states target their credits to specific types of businesses (e.g., high technology companies), while others follow the alternative, as well as the basic, federal research credit rules. Several states have credit rates that are higher than Minnesota's first tier (10 percent) rate and most allow rates higher than second tier (2.5 percent) rate. Finally, some state credits are not incremental, but rather apply to all qualifying research done in the state.

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

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: July 2014

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

For deaths in 2014, 31 states impose neither estate nor inheritance 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 no longer impose estate or inheritance taxes (31 states for deaths in 2014). Minnesota continues to impose an estate tax.

Inheritance and estate taxes differ in the base used to compute 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.

Twelve states and the District of Columbia impose only estate taxes

For decedents dying in calendar year 2014, 12 states (Connecticut, Delaware, Hawaii, Illinois, Maine, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia impose only estate taxes. Delaware and Hawaii allowed their taxes to expire after Congress repealed the credit for state death taxes, but reenacted the taxes in 2010.

Exemption amounts under the state estate taxes vary, ranging from the federal estate tax exemption amount or $5.34 million, indexed for inflation (two states) to $675,000 (New Jersey). The most common amount is $1 million (three states and the District of Columbia). In 2014, four states increased their exemption amounts: Minnesota (phased up to $2 million for 2018 deaths), Rhode Island ($1.5 million for 2015 deaths), and Maryland and New York (both phased their exemptions up to the federal amount for 2019 deaths). Top rates range from 12 percent to 19 percent with most states, like Minnesota, imposing a top rate of 16 percent.

Five states impose only inheritance taxes

Five states (Iowa, Kentucky, Nebraska, Pennsylvania, and Tennessee) impose only inheritance taxes. The Tennessee tax is scheduled to be eliminated for deaths after December 31, 2015.

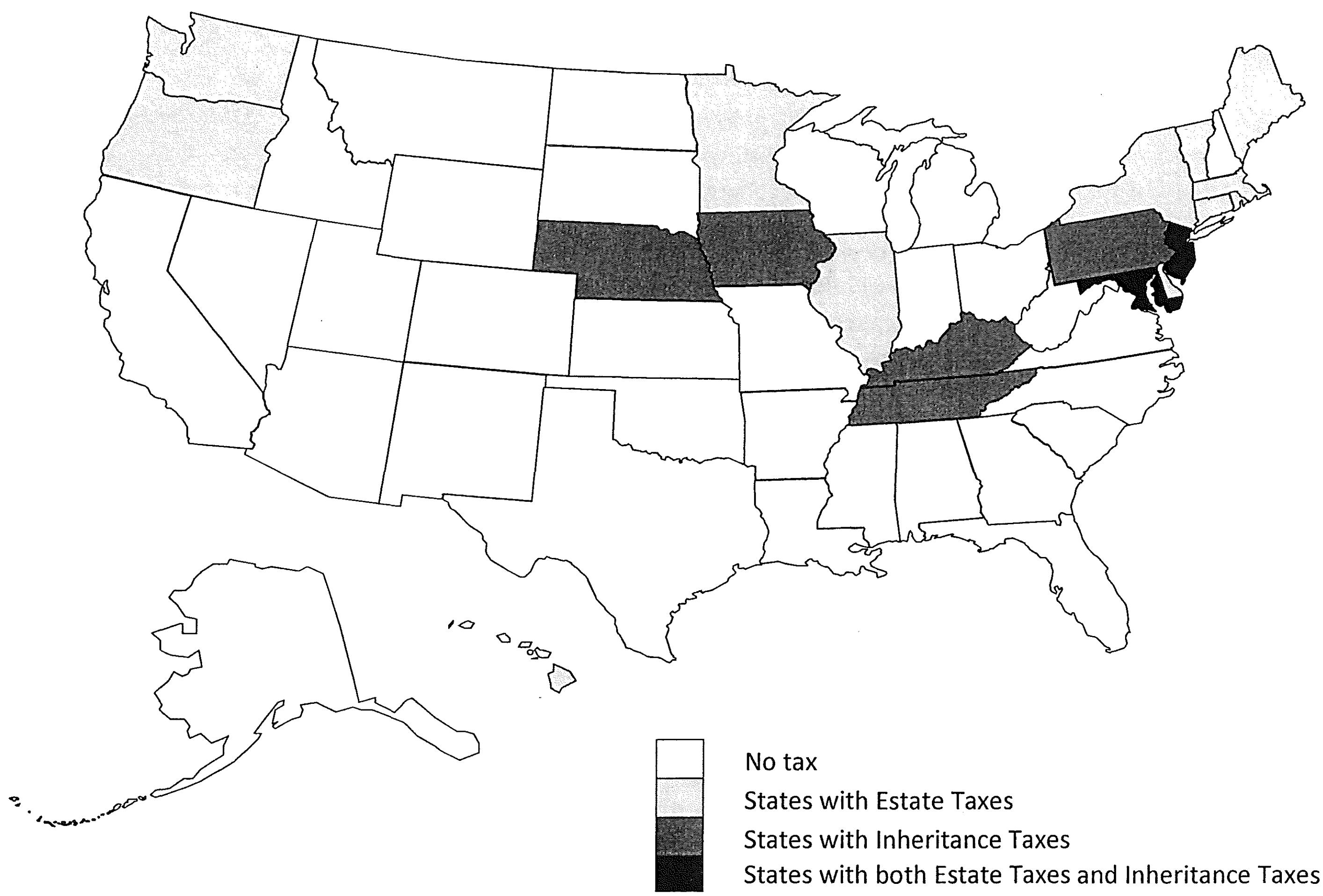
The exemptions under state inheritance taxes vary greatly, ranging from $500 (Kentucky and New Jersey) for bequests to unrelated individuals to unlimited exemptions (Iowa and Kentucky) for bequests to lineal heirs, such as children or parents of the decedent. No states tax bequests to surviving spouses. Top tax rates range from 4.5 percent (Pennsylvania on lineal heirs) to 18 percent (Nebraska on collateral heirs). Tennessee's inheritance tax is calculated more like an estate tax (i.e., the tax does not vary based on the beneficiary).

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 for deaths in 2014.

State Estate and Inheritance Taxes



House Research Department

For more information: See the information brief *Survey of State Estate, Inheritance, and Gift Taxes*, December 2013.

Lynn Aves

Updated: July 2014

Direct Care and Treatment

What is Direct Care and Treatment?

Direct Care and Treatment* is a division of the Minnesota Department of Human Services (DHS) that delivers publicly funded residential and treatment services to persons with complex needs. Direct Care and Treatment includes what was formerly known as State-Operated Services. It provides care and treatment for individuals who display complex conditions associated with mental illness, chemical dependency, developmental disabilities, traumatic brain injury, neurocognitive disorders, individuals who are committed to the Commissioner of Human Services as mentally ill and dangerous, and those who are committed with a sexual psychopathic personality or as a sexually dangerous person. Direct Care and Treatment provides services for clients at the Minnesota Sex Offender Program (MSOP), hospitals, treatment programs, and residential locations throughout the state. In addition, services are delivered through partial hospitalization, outpatient services, and mobile crisis teams. Services are organized under two categories of funding: "appropriated services" and "enterprise services."

What are appropriated services?

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

- **Services for adult mental health.** Direct Care and Treatment provides inpatient psychiatric services to adults at community-based behavioral hospitals located throughout the state and at the Anoka Metro Regional Treatment Center. Residential, partial hospitalization, and outpatient services are also provided to adult mental health clients. These services are delivered in partnership with counties and community service providers.
- **Services for persons committed as Mentally Ill and Dangerous.** Direct Care and Treatment operates the Minnesota Security Hospital (MSH) in St. Peter, a secure treatment facility that provides multidisciplinary treatment for adults and adolescents admitted under judicial and other lawful orders for assessment and treatment of major mental disorders. MSH also operates a 58-bed transition program providing treatment to increase skills necessary for a safe return to the community. In addition, MSH operates a forensic nursing facility for persons in need of nursing home care and who are committed as mentally ill and dangerous, sexual psychopathic personalities, sexually dangerous persons, or who are on medical release from the Department of Corrections.
- **Services for adults who pose a risk to public safety.** Direct Care and Treatment operates Minnesota Specialty Health Systems in five residential

community settings. The program provides intensive treatment to adults with complex needs and co-occurring disorders to improve client functioning and to identify support services that will permit clients to live in a less structured setting.

- **Minnesota Sex Offender Program.** MSOP provides inpatient services and treatment for individuals who are committed by the court as a sexual psychopathic personality or a sexually dangerous person. Facilities are located in St. Peter on the grounds of the Minnesota Security Hospital and in Moose Lake.

How are appropriated services funded?

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

What are enterprise services?

Direct Care and Treatment enterprise services provide services to people with disabilities while operating in the marketplace with other providers. These services are funded solely through revenues collected from a variety of third-party payment sources. Enterprise services provide the following:

- **Chemical Addiction Recovery Enterprise (CARE).** CARE provides inpatient and outpatient treatment to persons who are chemically dependent and abuse substances. CARE operates these programs in Anoka, Brainerd, Carlton, Fergus Falls, St. Peter, and Willmar. In conjunction with Hennepin County Medical Center, CARE provides intensive day treatment to residents of Hennepin County who are at risk of commitment due to chronic addiction.
- **Child and Adolescent Behavioral Health Services (CABHS).** CABHS provides an array of services ranging from outpatient to residential services for children and adolescents throughout the state. Inpatient services are provided at the Willmar hospital site.
- **Minnesota State-Operated Community Services (MSOCS).**
  - **Residential services for individuals with developmental disabilities or acquired brain injury.** MSOCS provides residential support services to people with disabilities in state-owned or state-leased homes, licensed foster care settings, or in the person's own home.
  - **Vocational and day training and habilitation (DT&H) services for individuals with developmental disabilities or acquired brain injury.** Vocational and DT&H programs provide vocational support services to persons through a licensed work site or supported work site with job coaches.

How are enterprise services funded?

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

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

* This publication was formerly published under the title of "State-Operated Services."

HOUSE RESEARCH | Short Subjects

Mark Shepard

Updated: July 2014

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 or 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.

The 2013 Legislature passed legislation increasing the governor's salary by 3 percent on January 1, 2015, and by 3 percent on January 1, 2016. Laws 2013, ch. 142, art. 6, § 12. Salaries of the other constitutional officers are a specified percentage of the governor's salary, so salaries of the other constitutional officers also will increase by 3 percent in 2015 and 3 percent in 2016. Laws 2001, 1st spec. sess., ch. 10, art. 1, § 2.

Officer	% of Governor's Salary	2013 Salary	2015 Salary	2016 Salary
Governor	---	$120,303	$123,912	$127,629
Attorney General	95%	$114,288	$117,716	$121,248
State Auditor	85%	$102,258	$105,326	$108,485
Secretary of State	75%	$90,227	$92,934	$95,722
Lt. Governor	65%	$78,197	$80,543	$82,959

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 must 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 4 percent on July 1, 2013, and 3 percent on July 1, 2014. Laws 2013, ch. 86, art. 3, § 12. Annual salaries for various judges beginning July 1, 2014, are as follows:

Official	2014 Salary
Supreme Court, chief	$172,012
Supreme Court, justice	$156,375
Court of Appeals, chief	$154,712
Court of Appeals, justice	$147,346
District Court, chief	$145,233
District Court, judge	$138,318

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 2013 Legislature proposed a constitutional amendment regarding how legislators' salaries are determined. The 2014 Legislature modified the text of the proposed amendment. That amendment will be voted on at the 2016 general election. Laws 2013, ch. 124; Laws 2014, ch. 282. If the amendment is adopted, salaries for legislators will be established by a newly created council appointed by the governor and by the chief justice of the Supreme Court.

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 and judges. Minn. Stat. § 15A.082. In 2014, the legislature removed the council's authority to make recommendations for legislators. A compensation council is appointed in January of each odd-numbered year. The council must make its recommendations to the legislature by April 15 of that 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 5.5 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: http://www.ser.leg.mn/salaries/electedsalaries130620.pdf.

Mark Shepard

Updated: July 2014

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 and compensation plans for nonunionized employees 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.

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

HOUSE RESEARCH | **Short Subjects**

Bob Eleff **July 2014**

State Authority to Promote Recycling

Recycling solid waste is near the top of the state's waste management hierarchy, second only to waste reduction and reuse, and ahead of composting, energy recovery through incineration, and land disposal. (Minn. Stat. § 115A.02) The hierarchy expresses policy preferences contained in the state's Waste Management Act rather than serving as an enforceable list of priorities; it indicates the significant position of recycling as a strategy to address solid waste problems.

State authority with respect to recycling falls within several categories. The Minnesota Pollution Control Agency (MPCA) is the executive branch agency responsible for implementing recycling and solid waste policies. Counties and cities conduct most recycling activities. State authority over recycling includes the following.

Setting recycling goals for counties and state agencies	The legislature sets goals for counties regarding the proportion of solid waste generated that must be recycled. The current goal for 2030 is 75 percent for counties in the metropolitan area and 35 percent for other counties. (Minn. Stat. § 115A.551) The legislature sets recycling goals for state agencies and itself. The current requirement is 60 percent, with a 2030 goal of 75 percent. (Minn. Stat. § 115A.15)
Requiring counties to offer recycling programs	Counties must develop and implement recycling programs to reach state recycling goals and must submit program strategies and budgets to MPCA for approval. (Minn. Stat. § 115A.551) Counties must ensure that all residents have an opportunity to recycle, via curbside pickup, centralized drop-off sites, or a local recycling center. (Minn. Stat. § 115A.552)
Requiring counties or manufacturers to recycle certain problem materials	Counties must recycle major appliances. (Minn. Stat. § 115A.9561) Producers of architectural paint, computer equipment, and mercury-containing thermometers must design, finance, and operate statewide programs to collect and recycle these materials. (Minn. Stat. §§ 115A.1310 et. seq.; 115A.1415; and 116.92)
Requiring certain businesses to recycle	Beginning in 2015, collegiate and professional sports facilities must collect and recycle at least three recyclable materials. (Minn. Stat. § 115A.551) Beginning in 2016, commercial businesses located in the metropolitan area that generate four cubic yards or more of solid waste weekly must collect and recycle at least three recyclable materials. (Minn. Stat. § 115A.551)

Providing financial assistance to counties to operate recycling programs

Under the Select Committee on Recycling and the Environment (SCORE) program, the MPCA distributes approximately $17.25 million annually from revenues from the tax on solid waste services to counties for recycling programs. (Minn. Stat. § 115A.557)

Recycling projects may receive grants for up to 50 percent of the capital cost of the project, up to $2 million. (Minn. Stat. § 115A.54)

The MPCA may award 50 percent matching grants to metropolitan counties for planning, developing, and operating recycling programs. (Minn. Stat. § 473.8441)

Prohibiting recycled materials from other methods of disposal

Recyclable materials may not be placed in a landfill or incinerated unless the commissioner has determined that no person will accept the materials. (Minn. Stat. § 115A.95)

Waste generated in the metropolitan area from which recyclables have not been removed may not be disposed of unless the waste is certified to be unprocessible. (Minn. Stat. § 473.848)

Encouraging the development of markets for recycled materials

The MPCA assists the development of reliable markets for recycled materials by developing state policies favoring the procurement of products containing recycled materials and sharing that expertise with local units of government, educational institutions, and other public agencies. (Minn. Stat. §§ 115A.15 and 115A.48)

For more information: Contact legislative analyst Bob Eleff at 651-296-8961.

HOUSE RESEARCH | Short Subjects

Anita Neumann **Updated: July 2014**

State Minimum Wage

The 2014 Minnesota Legislature enacted significant changes to the state's minimum wage structure, including phased-in minimum wage rate increases, alignment of the definitions of large and small businesses with those used under federal law, new youth and summer work-travel exchange visitor wage rates, and inflation adjustments to the wage rates. The major changes are highlighted below and are effective August 1, 2014, unless indicated otherwise.

What are the new state minimum wage rates?

Effective Date	Large Employer	Small Employer, Training Wage, Youth Wage	Summer Work-Travel Exchange Visitor
August 1, 2014	$8.00	$6.50	$7.25
August 1, 2015	$9.00	$7.25	$7.50
August 1, 2016	$9.50	$7.75	$7.75
January 1, 2018	Inflation adjusted	Inflation adjusted	Inflation adjusted

Who is a large employer?

A large employer is an enterprise with annual business activity or gross receipts of at least $500,000. The $500,000 business activity threshold is the same level used under the federal minimum wage law. The number of workers employed does not determine the wage rate an employer must pay.

Prior to August 1, 2014, the business activity/gross receipts threshold that determined whether an employer in Minnesota was "large" or "small" was $625,000 per year.

Who is a small employer?

A small employer is an enterprise with annual business activity or gross receipts of less than $500,000.

What is the training wage?

The training wage is a special wage rate that may be paid during the first 90 consecutive days of employment of a person under the age of 20. The training wage applies regardless of the size of the employer. The training wage has existed in Minnesota's minimum wage law for many years. The new training wage rate is at the same level as the small employer wage rate and the youth wage rate.

What is the youth wage?

A new youth wage may be paid to employees under the age of 18. The youth wage applies regardless of the size of the employer. The youth wage is at the same level as the small employer wage and the training wage.

What is the summer work-travel exchange visitor wage?

A new, special minimum wage must be paid by hotels, motels, lodging establishments, or resorts to employees working under a contract that includes employer-provided food and lodging if the employee is working under a summer work-travel exchange visitor program (J) nonimmigrant visa.

Additional information on the summer work-travel program may be obtained through the U.S. State Department at http://j1visa.state.gov/programs/summer-work-travel/.

Additional information about the definition of hotels, motels, lodging establishments, or resorts may be obtained from Minnesota Statutes, section 157.15, at https://www.revisor.mn.gov/statutes/?id=157.15.

How does indexing work?

The state minimum wage will be indexed to the rate of inflation (based upon the implicit price deflator) beginning January 1, 2018. The inflation adjustment, however, is limited to 2.5 percent per year even if the actual rate of inflation is higher. Wage rates cannot be adjusted downward. An inflation adjustment may be suspended if leading economic indicators—including projections of gross domestic product (GDP), consumer confidence, and state unemployment—indicate the potential for a substantial downturn in the state's economy.

What about employees who receive tips?

Minnesota does not allow a "tip credit," so tipped employees in Minnesota who are subject to the minimum wage provisions must be paid the minimum hourly wage regardless of whether they also receive tips. Additionally, the employer cannot require employees to share tips with the employer or with other employees.

Do employers pay the state or federal minimum wage?

An employer must pay the highest wage rate that applies, whether it is the state minimum wage rate or the federal minimum wage rate.

The current federal minimum wage rate, which became effective July 24, 2009, is $7.25 per hour. Additional information about the federal minimum wage may be obtained from the U.S. Department of Labor at http://www.dol.gov/whd/regs/compliance/whdfs14.pdf.

Minimum wage laws are enforced in Minnesota by the Minnesota Department of Labor and Industry and the U.S. Department of Labor.

How does Minnesota's minimum wage compare to the minimum wage in other states?

By January 1, 2015, according to information compiled by the National Conference of State Legislatures (NCSL), 26 states and the District of Columbia will have minimum wages above the federal minimum wage; 16 states, Guam, and the Virgin Islands will have minimum wages the same as the federal minimum wage; three states, American Samoa, and Puerto Rico will have minimum wages below the federal minimum wage; and five states will not have established a state minimum wage.

Additional information on wage rates in other states and scheduled increases in the states may be obtained from NCSL at http://www.ncsl.org/research/labor-and-employment/state-minimum-wage-chart.aspx.

What were the previous state minimum wage rates?

The state minimum wage rates prior to August 1, 2014, were: $6.15 per hour for large employers; $5.25 per hour for small employers; and a $4.90 per hour training wage.

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

HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff and Deborah Dyson

Revised: July 2014

Housing Improvement Areas

What are housing improvement areas?

A housing improvement area (HIA) is a defined area in a city in which housing improvements in condominium or townhome complexes may be financed with the assistance of the city, or the city's economic development authority (EDA) or housing and redevelopment authority (HRA).

Prior to 1996, cities needed special legislation to establish an HIA. In 1996, cities were granted the authority under general law. The general law, codified in Minnesota Statutes, sections 428A.11 to 428A.21, sunsets June 30, 2028.

What improvements can be made in an HIA?

The improvements that may be made under this law include improvements to the common elements in a condominium complex or townhome development. Examples include roofing, siding, landscaping, roadways, and walkways.

How is an HIA established?

At property owner's request. An HIA can only be established at the request (petition) of at least 50 percent of the owners of the housing units in the proposed area. If the petition is filed, then the city prepares an ordinance that:

- describes the area specifically;
- states the basis for imposing fees and the number of years the fees will be imposed;
- makes a finding that without the HIA, the proposed improvements could not be made; and
- specifies if the city, the EDA, or HRA will implement the ordinance.

In addition, the city must fully disclose the public expenditures and financing for the projects, and determine whether the association or the implementing agency will contract for the work.

Notice, public hearing, ordinance. Before adopting the ordinance, the city must hold a public hearing at which the proposed improvements, affected housing units, and the exempt units are listed. Fees can be imposed on the basis of the tax capacity (value) of the housing unit, total square footage of the housing unit, or a method determined by the city and specified in the resolution. Before a city uses an alternative method to set fees, it must make a finding that the alternative basis is more fair and reasonable. Potentially affected property owners may testify at the hearing. Those property owners may object in writing, and if the city agrees, may be excluded from the area or fee imposed.

The ordinance may be adopted within six months after the conclusion of the public hearing. If 45 percent or more of the affected residents file an objection, the HIA is not established.

How are the improvements financed?

The city may finance the housing improvements by:

(1) advancing funds available to the city and then recovering the costs by charging the property owners fees; or

(2) issuing bonds and then imposing fees or assessments to repay the bonds. The bonds are not included in the city's net debt and no election is required for their issuance.

Before imposing fees, the city must provide public notice and hold a public hearing. Within six months of the conclusion of the public hearing, the city may adopt a resolution to impose the fees.

What plans or reports are required?

Before the city imposes and collects the fee, the condominium or townhome association must develop a long-term plan to maintain the complex. The plan must address operations, maintenance, and necessary capital improvements of the common elements. It must identify financing for the projects. The association must also submit its audited financial report to the city annually.

How many cities have established HIAs?

It is difficult to determine how many cities have established HIAs. Although each city with an HIA is required to submit the HIA ordinance to the Commissioner of Revenue, the commissioner is not required to do anything with the ordinances, and there is no penalty for not filing. Also, it is impossible to know how much money is collected for HIA purposes statewide because the fees imposed are reported as special assessments by the cities and not identified separately.

The table below provides information on 13 cities known to have established HIA districts. The data is from the ordinances, city information on the Internet, or phone interviews with city staff.

City	Year first HIA established	Year most recent HIA established	# of Districts	# of units in a district (range)	Approx cost per unit (range)[1]	City bonds or city funds advanced
Anoka	2013		1	32	$1,338	funds advanced
Columbia Heights	2008		1	65	$42,000	bonds
Coon Rapids	1998	2006	10	8 – 39	$5,488 – 24,599	funds advanced
Eagan	2007	2012	3	50-220	$6,667 – 16,000	bonds/funds advanced
Eden Prairie	2013		1	20	$7,250	funds
Hopkins	1995	1997	3	176 – 328	$6,905 – 8,949	bonds
Little Canada	2008	2009	3	101 – 236	$3,798 – 20,772	bonds/funds advanced
Minneapolis	2013		1	107	$22,155	bonds
Minnetonka	2012		1	180	$3,744	funds advanced
New Hope	1997	2001	2	12 – 36	$15,756 – 18,056	bonds/funds advanced
Plymouth	1999		1	219	$7,630	bonds
Roseville	2009		1	47	$33,178	bonds
St. Louis Park	2002	2009	5	20 – 280	$4,879 – 16,625	bonds

For more information: Contact legislative analyst Andrew Biggerstaff at 651-296-8959 or Deborah Dyson at deborah.dyson@house.mn.

Colbey Sullivan Updated: July 2014

Biofuel Use Mandates

What is a biofuel?

A biofuel is a transportation fuel derived from plants or other renewable biological resources. The most widely used biofuels are ethanol produced from corn and biodiesel produced primarily from soybean oil. Ethanol is a substitute for gasoline; biodiesel is a substitute for diesel fuel. In contrast, gasoline and diesel are referred to as "fossil fuels" because they are created by processing nonrenewable petroleum. A biofuel-blended fuel is a fossil fuel mixed with biofuel.

Researchers and companies are actively developing new biofuels and new feedstocks for ethanol and biodiesel. In May 2012, a company opened the first commercial-scale biobutanol plant in Luverne.

What is a biofuel use mandate?

A biofuel use mandate is a law that requires transportation fuel suppliers and retailers to sell biofuel-blended fuel. As the result of Minnesota's biofuel mandates, in general all motorists who fuel up in Minnesota purchase biofuel-blended fuel. Regular gasoline and diesel are not typically available at gas stations.

How do the biofuel use mandates work?

Minnesota has two biofuel use mandates—one for gasoline and another for diesel fuel. Both laws require fuel blenders to incorporate a specific amount of biofuel in most transportation fuel sold in the state.

What is the requirement for gasoline?

Prior to July 1, 2013, state law required a 10 percent blend of ethanol in nearly every gallon of gasoline. This blend of 10 percent ethanol and 90 percent gasoline is commonly referred to as "E10." As the result of a law enacted during the 2013 legislative session, fuel sellers now have an option—they may sell either E10 or gasoline blended with 10 percent biobutanol, cellulosic ethanol, or any other biofuel approved by the U.S. Environmental Protection Agency (EPA) as a gasoline substitute.

By law, the E10 option could change if the EPA authorizes greater ethanol blends. In that case, fuel sellers who choose the ethanol option would be required to sell E15, E20, or any other blend approved by EPA for use in all light-duty vehicles. However, if EPA allows the use of new ethanol blends only in certain vehicles, the law's ethanol option will remain at E10. For example, EPA recently approved E15. However, Minnesota's ethanol mandate did not increase correspondingly because EPA authorized E15 use only in 2001 and newer vehicles.

What is the requirement for diesel?

The biodiesel mandate law currently requires a 10 percent blend of biodiesel ("B10") in most diesel fuel sold in Minnesota. Unlike ethanol, the EPA has already approved all diesel-biodiesel blends. The law calls for an increase to B20 on May 1, 2018. However, this target date is subject to change based on certain conditions specified in the law. For example, the scheduled increase from B5 to

B10 in May 2012 did not happen because executive branch agencies—as required by law and in consultation with nongovernmental stakeholders—determined that certain regulatory and supply issues were not sufficiently resolved. However, in the September 30, 2013, issue of the State Register, the same agencies posted notice that the statutory conditions had been met. As a result, the mandate increased from B5 to B10 on July 1, 2014. The B10 mandate is in effect April through September. October through March, the mandate level temporarily reverts to B5 due to concerns about B10's performance in cold weather.

The law also authorizes the executive branch to suspend the use mandate for a limited period of time if there is not enough biodiesel fuel available or if the wholesale price of biodiesel is so high relative to diesel fuel that the mandate would cause economic hardship for gas stations and other diesel fuel sellers who may lose business to competitors located outside of the state.

What exemptions exist?

The legislature granted specific exemptions from the mandates for certain vehicles, equipment, and fuels. The exemptions reflect stakeholder concerns about the suitability of biofuel-blended fuels for their vehicles and other gasoline- or diesel-powered equipment. For a list of exemptions, see the table below.

Biofuel Mandates, Implementation Dates, and Exemptions

	Diesel	Gasoline
Mandate Level	10 percent biodiesel per gallon April through September; otherwise 5 percent. Scheduled to increase to 20 percent April through September in 2018 and thereafter	Option of (1) the highest ethanol blend approved by the U.S. EPA for all vehicles, or (2) 10 percent of another EPA-approved biofuel
Initial Implementation	2005	2003*
Exemptions	Nuclear plants, trains, off-road mining and logging equipment, generator manufacturers, Coast Guard boats and certain boats subject to Coast Guard inspection. Number 1 diesel fuel is exempt entirely until May 1, 2020	Aircraft, resorts, marinas, houseboat companies, recreational vehicle manufacturers, riparian landowners, motor sport racing events, collector vehicles, off-road vehicles, motorcycles, boats, snowmobiles, and small engines

*The legislature required E10 use statewide in 2003. From 1997 to 2003, the law effectively required E7.7 statewide.

For more information: For mandate compliance information, contact the Minnesota Department of Commerce, Weights and Measures Division, at 651-215-5821. For more detail on the mandates, see the following reports from the Minnesota Department of Agriculture: *Legislative Report on Ethanol – Review of E20* (January 2011) and *Biodiesel Annual Report to the Legislature* (January 2014), available at www.mda.state.mn.us/renewable.aspx. For legislative issues, contact legislative analyst Colbey Sullivan at 651-296-5047.

Mark Shepard

Updated: July 2014

State Agency Head Salaries

The governor establishes most agency head salaries

The governor establishes the salaries for most state executive branch agency heads, within limits set in law. For most agency heads, the limit is 133 percent of the governor's salary, to be adjusted for inflation each January. For several, the limit is 120 percent of the governor's salary, to be adjusted for inflation each January. Minn. Stat. § 15A.0815, subds. 2 and 3. Individual agency head salaries within the limits set in law are not subject to legislative approval.

The current limit for most agency heads is $161,603 (133 percent of the governor's current salary of $120,303, with an inflation adjustment applied in January 2014). The agency head salary limits will increase on January 1, 2015, and again on January 1, 2016, both because of the inflation adjustment and because the governor's salary is scheduled to increase by 3 percent on each of those dates. As indicated in the table below, none of the agency head salaries currently is close to the limit.

The legislature changed this system in 2013. Before the 2013 changes, agency head salaries were limited to 95 percent (or in several cases 85 percent) of the governor's salary, and individual agency head salaries within the salary limits required legislative approval.

There is a different process for setting some agency head salaries

There is a different process for setting salaries for heads of the statewide public pension funds, the lottery director, and the executive director of the State Board of Investment.

- For directors of the three statewide public pension funds, the governing board of the applicable pension system sets the salary, within the statutory limit of 133 percent of the governor's salary. These salaries are subject to legislative approval. Minn. Stat. § 15A.0815, subds. 2 and 5.
- The lottery director salary is set in statute at 95 percent of the governor's salary. Minn. Stat. § 349A.02, subd. 1.
- The salary for the executive director of the State Board of Investment is set by the board, under a compensation plan approved by the Subcommittee on Employee Relations of the Legislative Coordinating Commission and the full legislature. Minn. Stat. §§ 11A.04, cl. 14, and 43A.18, subd. 3b.

Agency head salaries

The following table lists the salaries for agency heads who are subject to the salary limits specified in statute. Most of the cabinet agency salaries were last increased by 5 percent as of January 2013 and by 5 percent as of January 2014. Before that, most salaries were last increased in 2000.

Cabinet Agencies	Salaries
Administration	$119,517
Agriculture	119,517
Commerce	119,517
Corrections	119,517
Education	119,517
Employment and Economic Development	119,517
Health	119,517
Office of Higher Education	119,517
Housing Finance Agency	119,517
Human Rights	119,517
Human Services	143,281
Iron Range Resources and Rehabilitation	105,465
Labor and Industry	119,517
Management and Budget	119,517
Mediation Services	105,465
Natural Resources	119,517
Pollution Control Agency	119,517
Public Safety	119,517
Revenue	119,517
Transportation	119,517
Veterans Affairs	119,517
Other Agencies	
Gambling Control Board	$95,067
Metropolitan Airports Commission, Chair	20,833
Metropolitan Council, Chair	58,489
Ombudsman for Mental Health and Developmental Disabilities	97,510
Pari-mutuel Racing	88,455
Public Utilities Commission	92,853
Minnesota State Retirement System	126,303
Public Employees Retirement Association	132,480
Teachers Retirement Association	132,480

For more information: Contact legislative analyst Mark Shepard at 651-296-5051. Also see the House Research publication *State Elected Officials' Compensation*, July 2014.

Colbey Sullivan and Nina Manzi **Updated: July 2014**

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of Minnesota Management and Budget (MMB) 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 2014 forecast will provide the revenue and expenditure projections that the governor will use in developing the budget proposal for the fiscal year 2016-2017 biennium, which runs from July 1, 2015, to June 30, 2017. The November 2014 forecast will also show if the state is on track to finish the fiscal year 2014-2015 biennium with a balanced budget.

The February forecast modifies the preceding November's forecast with any new data that's available. The February 2015 forecast will provide the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2016-2017 biennium. Following the February forecast, the governor will submit modifications to the budget proposal developed from the November forecast, which are called "supplemental budget recommendations." The February 2015 forecast will also provide 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 2015 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2016-2017 budget during the 2016 legislative session. The legislature will use the projections in the February 2016 forecast to ensure that the fiscal year 2016-2017 biennium closes with a balanced budget.

What if a forecast shows a budget shortfall?

If a forecast projects a shortfall for the *general fund in the current biennium*, the commissioner of MMB 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 MMB must reduce allotments from that fund to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations to the legislature 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 MMB must allocate the surplus in priority order as follows:

1. to the cash flow account, until it reaches $350 million (currently satisfied)
2. to the budget reserve account, until it reaches $810.992 million (currently satisfied)
3. to increase the school aid payment schedule to 90 percent, in increments of one-tenth of 1 percent with any residual amount deposited in the budget reserve (currently satisfied)
4. to restore previous school aid reductions and reduce the property tax recognition shift accordingly (currently satisfied)

If a November forecast projects a surplus and priorities (1) to (4) have been satisfied, 33 percent of the surplus is transferred to the budget reserve, until the reserve reaches the percentage of the current biennium's revenues recommended as a reserve. The commissioner must update the percentage each January based on a review of the adequacy of the reserve and the volatility of Minnesota's tax structure.

Any surplus remaining after meeting the four priorities and making the 33 percent transfer is reported in the forecast as a "positive unrestricted budgetary general fund balance."

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

What are recent changes to treatment of budget surpluses?

Laws 2014, chapter 150, requires the commissioner to recommend a budget reserve level specified as a percentage of current biennium revenues, to update the percentage each January, and to transfer 33 percent of a November forecast surplus to the reserve.

Laws 2014, chapter 150, also removed restoration of $15 million transferred in 2008 from the state airports fund to the general fund from the list of priorities, since this item was satisfied following the November 2013 forecast.

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

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: July 2014

Survey of State and Local Gasoline Taxes

This short subject shows state and local gasoline taxes in each state as of July 1, 2014. Because of the interrelationship in some states between per-gallon gasoline taxes and gasoline sales taxes, and between state and local gasoline taxes, a compilation of all such taxes is necessary to reflect each state's total tax burden. While all states impose per-gallon taxes, eight states also impose sales taxes (which fluctuate based on price), and ten states allow local gas or sales taxes to be imposed. Minnesota's total tax burden on gasoline, which includes the 28.5-cent per-gallon excise tax, 2-cent cleanup fee, and 0.1-cent inspection fee, places it 16th highest based on state taxes and 20th highest based on total state and local taxes.

Gasoline taxes include state and local taxes

The columns in the table below represent the following:

- State excise tax: Per-gallon tax on gasoline imposed at the state level
- State sales tax: State retail sales tax applied to gasoline; in some states, the sales tax rate is prefigured and prepaid at the wholesale level rather than being calculated and paid at the pump
- Other state tax/fee: Leaking underground storage fees, inspection fees, various environmental fees; in some states, including Minnesota, these are "blink-on" taxes that are imposed whenever a specified fund reaches a certain level; the table applies these fees, if they applied on July 1, 2014
- Total state taxes: Combined per-gallon tax, sales tax, other state taxes and fees
- Local excise tax: Locally imposed per-gallon taxes in the largest city in the state
- Local sales tax: Local retail sales taxes that apply to gasoline in the largest city in the state
- Total local tax: Combined local gas taxes and sales taxes
- Total tax: Combined state and local taxes

For price-based taxes, U.S. Energy Information Administration price data for the week of June 30, 2014, was used for the applicable region, state, or city. This price was adjusted in those states that impose a sales tax on gasoline, but excludes state or federal per-gallon taxes from the taxable price.

Total State and Local Taxes on Gasoline as of July 1, 2014

	State Excise Tax	State Sales Tax	Other State Tax/Fee	Total State Tax	State Rank	Local Excise Tax	Local Sales Tax	Total Local Tax	Total State and Local Tax	Total Taxes Rank
Alabama	$0.160		$0.049	**$0.209**	37	$0.010		**$0.010**	**$0.219**	**37**
Alaska	0.080			**0.080**	50				**0.080**	**50**
Arizona	0.180		0.010	**0.190**	41				**0.190**	**42**
Arkansas	0.215		0.003	**0.218**	35				**0.218**	**38**
California	0.360	0.095	0.084	**0.539**	1		0.064	**0.064**	**0.603**	**3**
Colorado	0.220			**0.220**	33				**0.220**	**35**

Total State and Local Taxes on Gasoline as of July 1, 2014										
	State Excise Tax	State Sales Tax	Other State Tax/Fee	Total State Tax	State Rank	Local Excise Tax	Local Sales Tax	Total Local Tax	Total State and Local Tax	Total Taxes Rank
Connecticut	0.250		0.243	**0.493**	2				**0.493**	**5**
Delaware	0.230		0.070	**0.300**	17				**0.300**	**21**
Florida	0.040	0.131	0.013	**0.184**	44	0.132		**0.132**	**0.316**	**18**
Georgia	0.075	0.118		**0.193**	40		0.148	**0.148**	**0.341**	**13**
Hawaii	0.170	0.157	0.055	**0.382**	8	0.165	0.020	**0.185**	**0.567**	**4**
Idaho	0.250		0.010	**0.260**	25				**0.260**	**28**
Illinois	0.190	0.228	0.011	**0.429**	3	0.110	0.118	**0.228**	**0.657**	**1**
Indiana	0.180	0.229	0.010	**0.419**	6				**0.419**	**7**
Iowa	0.210		0.010	**0.220**	33				**0.220**	**35**
Kansas	0.240			**0.240**	27				**0.240**	**30**
Kentucky	0.285		0.014	**0.299**	19				**0.299**	**22**
Louisiana	0.200		0.001	**0.201**	38				**0.201**	**40**
Maine	0.300		0.010	**0.310**	15				**0.310**	**19**
Maryland	0.274			**0.274**	22				**0.274**	**25**
Massachusetts	0.240		0.025	**0.265**	24				**0.265**	**27**
Michigan	0.190	0.223	0.009	**0.422**	4				**0.422**	**6**
Minnesota	**0.285**		**0.021**	**0.306**	**16**				**0.306**	**20**
Mississippi	0.180		0.004	**0.184**	43				**0.184**	**44**
Missouri	0.170		0.003	**0.173**	45				**0.173**	**45**
Montana	0.270		0.008	**0.278**	21				**0.278**	**24**
Nebraska	0.264		0.009	**0.273**	23				**0.273**	**26**
Nevada	0.230		0.008	**0.238**	31	0.166		**0.166**	**0.404**	**9**
New Hampshire	0.222		0.016	**0.238**	30				**0.238**	**33**
New Jersey	0.105		0.040	**0.145**	48				**0.145**	**48**
New Mexico	0.170		0.019	**0.189**	42				**0.189**	**43**
New York	0.080	0.155	0.184	**0.419**	5		0.189	**0.189**	**0.609**	**2**
North Carolina	0.365		0.003	**0.368**	10				**0.368**	**11**
North Dakota	0.230			**0.230**	32				**0.230**	**34**
Ohio	0.280			**0.280**	20				**0.280**	**23**
Oklahoma	0.160		0.010	**0.170**	46				**0.170**	**46**
Oregon	0.300			**0.300**	18	0.030		**0.030**	**0.330**	**15**
Pennsylvania	0.407		0.011	**0.418**	7				**0.418**	**8**
Rhode Island	0.320		0.010	**0.330**	12				**0.330**	**14**
South Carolina	0.160		0.008	**0.168**	47				**0.168**	**47**
South Dakota	0.220		0.020	**0.240**	29				**0.240**	**32**
Tennessee	0.200		0.014	**0.214**	36				**0.214**	**39**
Texas	0.200			**0.200**	39				**0.200**	**41**
Utah	0.245			**0.245**	26				**0.245**	**29**
Vermont	0.121		0.209	**0.330**	13				**0.330**	**16**
Virginia	0.111		0.006	**0.117**	49				**0.117**	**49**
Washington	0.375			**0.375**	9				**0.375**	**10**
West Virginia	0.205		0.152	**0.357**	11				**0.357**	**12**
Wisconsin	0.309		0.020	**0.329**	14				**0.329**	**17**
Wyoming	0.230		0.010	**0.240**	28				**0.240**	**31**

Note: The table does not include special tax rates for alcohol-gasoline blends or for gasoline used in commercial vehicles.
Sources: Federation of Tax Administrators; American Petroleum Institute; U.S. Energy Information Administration; and state revenue agency websites.

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

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

Lynn Aves

Updated: August 2014

Child Support: Basic Questions

When is child support ordered?

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

What does child support include?

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

Who pays child support, and who receives it?

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

How is the child support amount calculated?

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

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

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

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

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

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

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

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

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

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

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

How is support enforced if payments are not made?

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

For more information: Anyone affected by a child support order can call his or her county child support office or the automated DHS Child Support Help Line at 651-296-2542 or 1-800-657-3954. See also the DHS child support website at www.dhs.state.mn.us/main/id_000160. See the House Research Department publication *Minnesota's Child Support Laws: An Overview* for more information about the law.

HOUSE RESEARCH | Short Subjects

Lisa Larson

August 2014

Student Bullying Policy

The 2014 Legislature passed the Safe and Supportive Minnesota Schools Act, which implements new standards for anti-bullying policies in Minnesota schools. This short subject describes the act, but readers should consult Laws 2014, chapter 160, to understand the extensive details of the law and its requirements.

School districts and public schools must have a comprehensive student bullying policy

Minnesota's 2014 student bullying law requires school districts and public schools, including charter schools, to have a comprehensive student bullying policy. The law prohibits student-on-student bullying at school, at school functions and activities, or on school transportation. It also covers students' use of electronic technology and communications at school and elsewhere, if such use materially and substantially disrupts student learning or the school environment. The law does not apply to home school and nonpublic school students, unless the students voluntarily participate in public school activities. Nonpublic schools are encouraged to report summary data on student bullying.

The law defines bullying, cyberbullying, prohibited conduct, and other terms

Bullying is intimidating, threatening, abusive, or harmful conduct that is objectively offensive and is repeated or forms a pattern and involves either a real or perceived power imbalance between students, or materially and substantially interferes with a student's education. The conduct is defined as something that: may cause, or causes fear of, physical harm to person or property; violates an expectation of privacy; defames; causes intentional infliction of emotional distress; or is directed at a student's characteristics. Cyberbullying is bullying using technology or electronic communication.

The law prohibits bullying, cyberbullying, retaliating against a student who reports bullying, and falsely reporting bullying. Districts and public schools must use remedial measures to stop, correct, and prevent prohibited conduct and intervene to help a student subjected to prohibited conduct.

School districts and public schools must adopt and implement a local policy or the state model policy on bullying

Districts and public schools must adopt, post, and otherwise disseminate either a local policy or the state policy. A local policy must include best preventive, remedial, and disciplinary practices that foster student, parent, and community participation. Districts and public schools may include in their local student bullying policy the components of policies developed by education stakeholders, including the Minnesota Department of Education, the Minnesota School Boards Association, and the Minnesota Association of School Administrators.

Districts and schools must: discuss their bullying policy with students, school personnel and volunteers; and train school personnel at least every three years and new employees within the first year of employment. They must also submit a copy of their bullying policy to the education commissioner.

A local student bullying policy must include specific components

The law requires a local policy to:

- designate a primary contact person;
- require school employees to address and resolve bullying;
- require the primary contact person or designee to begin to investigate a bullying report within three days and to make and keep a record;
- indicate how the school will respond to bullying incidents, including whether to notify parents and the nature of remedial responses;
- prohibit and establish consequences for reprisals and retaliation for reporting bullying;
- allow but not rely solely on anonymous reporting;
- make available information about community resources;
- as appropriate, include in an individualized education program or 504 plan the skills and proficiencies a child with disabilities needs to cope with bullying;
- publicize the policy using employee and student publications;
- require ongoing professional development for school personnel that includes strategies, the complex dynamics, research, and information on bullying, cyberbullying and Internet access;
- allow a student being investigated to present a defense; and
- inform affected students and parents about their right to access and correct data on the student.

School districts and public schools may use a state model policy instead of a local policy

The education and human rights commissioners must develop and maintain a state model anti-bullying policy that districts and schools may use instead of a local policy. The education commissioner must help the districts and schools that are implementing the state policy. The state policy must: define and apply the components of prohibited conduct in this law; where appropriate, allow an individualized education program or 504 plan to include the skills and proficiencies a child with disabilities needs to cope with bullying; and encourage violence prevention and character development education programs. The education commissioner must post procedures to review district and school compliance and investigate and respond to noncompliance reports and complaints.

Districts and schools are encouraged to provide programs to help the community address bullying

Districts and schools are encouraged to help students address bullying, value diversity, solve problems, manage conflict, be civil, and prevent and intervene with bullying. Districts and schools also are encouraged to engage the school community in prevention and intervention programs. The school safety technical assistance center, upon request, must help students understand social media and cyberbullying. Districts and schools must establish strategies and use evidence-based social-emotional learning to address discrimination and other conduct.

Law clarifies the effect on other laws

This law does not establish the right to sue, limit individuals' civil or criminal law rights, or interfere with individuals' rights of free speech and expression.

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

HOUSE RESEARCH | Short Subjects

Danyell A. Punelli **August 2014**

Medicaid Long-Term Care Costs

What is the Medicaid Program?

Medicaid, or Medical Assistance (MA) as it is called in Minnesota, is a joint federal-state health care program that provides necessary medical services for low-income families, children, pregnant women, and people who are elderly (65 or older) or have disabilities.

Medicaid home- and community-based waivers were established under section 1915(c) of the federal Social Security Act of 1981. The waivers were intended to correct a bias toward institutional care in the Medicaid program. They allow states to offer a broad range of home- and community-based services to people who may otherwise be institutionalized.

In 1999, the U.S. Supreme Court ruled in *Olmstead vs. L.C.* that states have an obligation to ensure that people with disabilities are not forced to remain institutionalized when a more integrated setting is appropriate and the affected people do not object to the community placement. The court also indicated that states should have comprehensive, effective working plans for placing qualified people in less restrictive settings. This ruling prompted states, including Minnesota, to review their policies and practices and to determine whether they were most effectively supporting the relocation and diversion of people from institutional settings.

What are the funding sources for MA long-term care services?

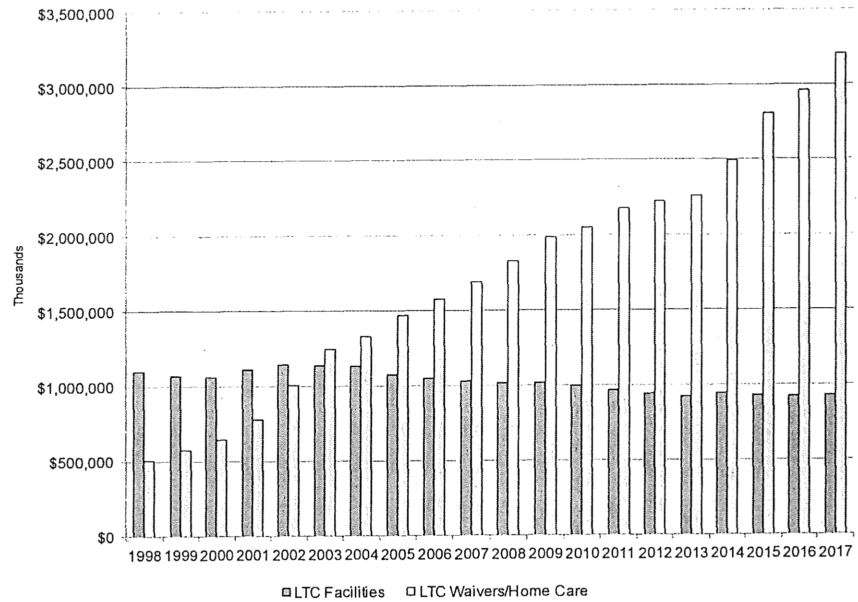
The federal government pays a share of the cost of state MA expenditures. This is referred to as the federal medical assistance percentage (FMAP). Minnesota's usual federal match is 50 percent. The state pays the remaining 50 percent for most services (some services have a county share, such as long-term placements in ICF/DD facilities with seven or more beds). In fiscal year 2014, the projected total expenditure for all long-term care services was $3.4 billion, with a state share of $1.7 billion.

How do the expenditures compare for long-term care facilities versus waivers and home care?

The average monthly payment per recipient for long-term care facilities (nursing facilities, county nursing facilities, ICF/DD facilities, and the State-Operated Services Mental Illness Program) is estimated to be $4,487 in fiscal year 2014. This is higher than the estimated average monthly payment per recipient of $3,701 for MA home and community-based waiver and home care (BI, CAC, CADI, DD, and elderly waiver and home health agency services, personal care, and home care nursing services).

As shown below, the total expenditures for the long-term care facilities have decreased over the past few fiscal years while total expenditures for long-term care waivers and home health care have been increasing rapidly, even though the average monthly payments for both types of services have increased over time. This is mainly due to changes in participation rates between programs.

Total Annual Payments for LTC Facilities vs. Waivers/Home Care
Fiscal Years 1998 to 2017

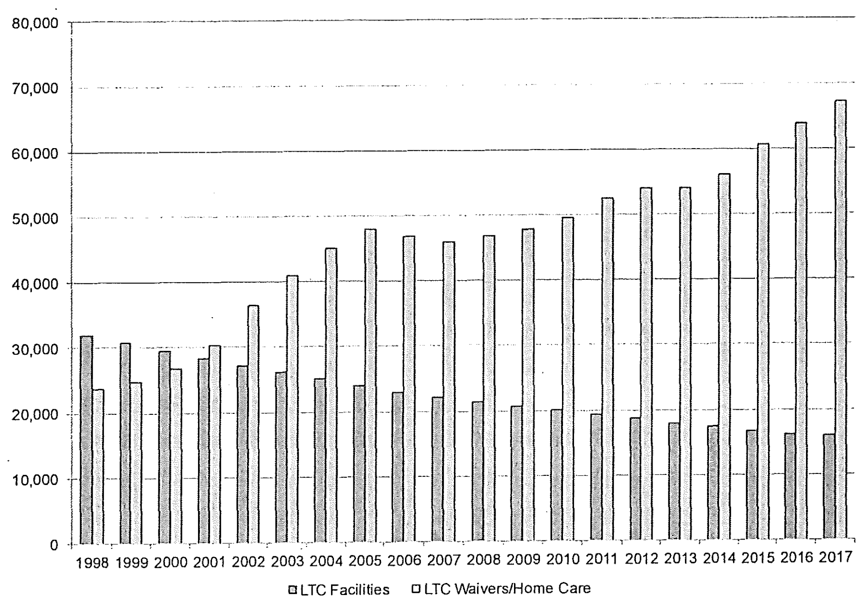


Source: February 2014 Department of Human Services Forecast of Revenues and Expenditures.
Note: Fiscal Year 2014 to 2017 numbers are projected.

How many people receive MA long-term care services?

In fiscal year 2014, the monthly average number of recipients for MA long-term care facilities and waiver/home care services was 73,583. As shown below, the average number of recipients each month has declined in MA long-term care facilities but increased for MA long-term care waivers and home care during the same time period.

Monthly Average Recipients for LTC Facilities vs. Waivers/Home Care
Fiscal Years 1998 to 2017



Source: February 2014 Department of Human Services Forecast of Revenues and Expenditures.
Note: Fiscal Year 2014 to 2017 numbers are projected.

For more information: Contact legislative analyst Danyell A. Punelli at 651-296-5058. Also see the House Research publication *Medicaid Home- and Community-based Waiver Programs*, November 2013.

Deborah A. Dyson

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State-Local Relations

All local governmental units are creatures of the state and subject to the will of the state legislature, within any constitutional restrictions.

"Local Government"

"Local government" is a general term for those governmental entities or political subdivisions of the state that provide functions and services at the local level. In Minnesota, the term usually refers to counties, towns (townships), and cities. Single- or multipurpose (special) districts are frequently included in the term "political subdivision" but are less often defined as local governments.

Cities and towns are general purpose local governments. Counties were originally established to be administrative arms of the state to administer elections, tax assessments and collections, and state programs. Over time, counties have been given more authority to function as general purpose local governments.

Creatures of the State

The U.S. Constitution is silent on local government. Control of local government is not one of the enumerated federal powers of the Constitution, nor is it expressly prohibited to the states. It is, therefore, a residual power left to the states and people by the Tenth Amendment. Furthermore, local units of government do not have recourse to the federal constitution in order to resist state legislative interference or control. *Williams v. Mayor and City Council of Baltimore*, 289 U.S. 36, 40, 53 S.Ct. 431, 432 (1933) ("A municipal corporation, created by a state for the better ordering of government, has no privileges or immunities under the Federal Constitution which it may invoke in opposition to the will of its creator.").

Under the Minnesota Constitution, "The legislature may provide by law for the creation, organization, administration, consolidation, division and dissolution of local government units and their functions, for the change of boundaries thereof, for their elective and appointive officers including qualifications for office and for the transfer of county seats. A county boundary may not be changed or county seat transferred until approved in each county affected by a majority of the voters voting on the question." Minn. Const. art. XII, § 3. Several chapters of Minnesota Statutes are devoted to just these purposes.

Powers of a Municipal Corporation: Dillon's Rule

Local governments "possess only those powers that are conferred by statute or implied as necessary to carry out legislatively conferred powers." *Breza v. City of Minnetrista*, 725 N.W.2d 106, 110 (Minn. 2006). This basic principle of what powers a local government has follows the principle first stated in 1872 in a treatise on municipal corporations, written by Iowa Supreme Court Judge John F. Dillon; it is known as Dillon's Rule. The two major modifications the legislature has made to the rule are the authority for cities to adopt home rule charters and the broad grant of authority to legislate for the general welfare.

Modification of Dillon's Rule: Home Rule Charters

The legislature has granted cities the authority to adopt home rule charters; this action is the first significant mechanism in diminishing the practical effect of Dillon's Rule. A home rule charter, or a local constitution, not only provides for the particular governmental organization of a municipality but also provides for substantive authority to be exercised by the governing body for the community. A charter must be consistent with the state constitution, and state law can overrule a charter provision.

The Minnesota Constitution authorizes any local government unit, when authorized by law, to adopt a home rule charter for its government. Minn. Const. art. XII, § 4. A charter must be approved by the voters of the local government unit as prescribed by general law.

A city may adopt a home rule charter following the procedures in Minnesota Statutes, chapter 410. Of the 853 cities in the state, 107 are home rule charter cities and the others are known as statutory cities. There is no general law enabling other local units of government to adopt home rule charters. A 1987 special law allowed Ramsey County to establish a commission to study the need or desirability of a home rule charter for the county, and if necessary to prepare and present a charter to the voters of the county. The voters approved a charter in 1990.

Modification of Dillon's Rule: General Welfare

The statutory authority to legislate for the general welfare also mitigates the severity of Dillon's Rule. It is a broad grant of authority for a local government to exercise any power not enumerated specifically that contributes to the protection of the health, morals, peace, and good order of the community; promotes its welfare in trade, commerce, and manufacture; or aids in carrying out all appropriate objects contemplated in the creation of a city.

All statutory cities in Minnesota have authority to legislate for the general welfare. Minn. Stat. § 412.221, subd. 32. Home rule charter cities simply include a general welfare clause or "all powers clause" within the provisions of their charters. Towns have the same authority in statute. Minn. Stat. §§ 365.10, subd. 17; 368.01, subd. 19.

Counties do not have "general welfare" authority, although Minnesota Statutes, section 145A.05, is sometimes viewed as providing a relatively broad grant of authority by authorizing ordinances protecting the public health.

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

HOUSE RESEARCH | Short Subjects

Lisa Larson

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Regulating Students' Online Speech Under the First Amendment

In an era where the Internet is integral to public speech, students' online free speech rights in public elementary and secondary schools and universities are unsettled. For example, it is not clear whether First Amendment standards affecting student speech in public elementary and secondary schools apply equally to universities, whether it matters that online speech occurs on or off campus, or whether offensive or otherwise harmful communications posted on Facebook or other social media are public or private.

Courts exercise restraint when considering the policy decisions of school officials

Courts generally recognize school officials' authority over K-12 students and exercise restraint when considering the policy decisions that school officials make. However, school officials' authority is not boundless and students retain free speech rights in school, even if those rights are limited by previous U.S. Supreme Court decisions dealing with First Amendment rights.

The U.S. Supreme Court has decided four major cases regulating K-12 First Amendment student speech on campus or at a school activity

The way in which First Amendment speech standards apply to students' online speech is unsettled law. In the last 40 years, the U.S. Supreme Court has decided four major cases regulating student speech in elementary and secondary schools, none of which specifically address students' online speech.

- In *Tinker v. Des Moines Independent Community School District*, 393 U.S. 503 (1969), the school district suspended students for wearing black arm bands in school to protest the Vietnam War. The court ruled that schools could ban student speech only if it materially and substantially disrupted the work and discipline of the school. The court found the students' suspensions unconstitutional because school officials had no reason to believe the students' black arm bands would cause a material disruption in the school.
- In *Bethel School District v. Fraser*, 478 U.S. 675 (1986), in order to teach the boundaries of socially appropriate behavior, the court allowed secondary school officials to prohibit a student's speech containing "explicit sexual metaphors," regardless of whether the speech materially or substantially disrupted the education process.
- In *Hazelwood School District v. Kuhlmeier*, 484 U.S. 260 (1988), the court allowed school officials to remove from a school-sponsored student newspaper, articles on teen pregnancy because the topic was inappropriate for younger students and unfair to pregnant students who might be identified from the text. The court held that school officials can censor school-sponsored student publications produced as part of a journalism class in order to address legitimate educational concerns.
- In *Morse v. Frederick*, 551 U.S. 393 (2007), a principal suspended a student for holding up a banner at a school-sponsored event with the message "Bong Hits 4 Jesus," a slang reference to marijuana smoking. The court ruled that school officials can prohibit students from displaying messages that promote

illegal drug use.

The U.S. Supreme Court recently refused to hear two student online speech cases

The U.S. Supreme Court recently let lower court decisions stand when it refused to hear two student online speech cases. In *J.S. v. Blue Mountain Sch. Dist.,* 650 F.3d 915 (3d Cir. 2011), a middle school student used her home computer to create a phony MySpace profile that cruelly ridiculed her school principal. The Third Circuit Court ruled the district could not reasonably show the spoof profile would substantially disrupt the school, and the decision to suspend the student violated her First Amendment right to speech.

In *Kowalski v. Berkeley Count Sch.*, 652 F.3d 565 (4^{th} Cir. 2011), a high school student used her home computer to create a MySpace chat group page SASH (Students Against Sluts Herpes) that successfully encouraged vulgar and offensive comments about another student. The Fourth Circuit Court ruled that the student's speech was not constitutionally protected because the distress it inflicted on the targeted student disrupted the school. (Minnesota is in the 8^{th} Circuit.)

Minnesota's antibullying law prohibits online student speech that disrupts the school

In Minnesota, there is limited state oversight of elementary and secondary students' online speech on or off campus, but state laws do address bullying in schools. Minnesota Statutes, section 121A.031, requires school boards to adopt a policy prohibiting student bullying that occurs "by use of electronic technology and communications off the school premises to the extent such use substantially and materially disrupts student learning or the school environment."

The U.S. Supreme Court has not decided the standard of review for university students' speech

It is not clear whether the U.S. Supreme Court's secondary students' free speech analysis applies equally in a university setting. The court reserved in a footnote in *Hazelwood* the question of whether the deferential standard of review used to regulate high school speech in a school-sponsored student newspaper also applies to universities. However, the court has not upheld a restriction on university students' speech, and most of the speech-related cases the court has reviewed have implicated universities' funding of student groups on campus.

The Minnesota Supreme Court allowed the University of Minnesota to punish a student for satirical Facebook comments

In 2012, the Minnesota Supreme Court in *Tatro v. University of Minnesota* ruled that the University of Minnesota did not violate a college student's free speech rights when it punished her for posting satirical Facebook comments about the school cadaver she was working on as part of the university's mortuary science program; the program prepares students to become funeral directors and morticians. The court found the university's sanctions of Amanda Tatro's off-campus online speech justified because she violated the university's narrowly tailored academic program rules that directly relate to established standards of professional conduct in mortuary science. The court noted that it was the specific circumstances of the case—a professional program that operates under standards of professional conduct, a program that gives students access to donated human cadavers, written program rules that require a high degree of respect for human cadavers, and discipline that was not arbitrary or intended to punish the student for protected speech—that accounted for the court's narrow holding.

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

Andrew Biggerstaff

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Statutory New Home Warranties

What defects are covered by the statutory warranty?

Minnesota law provides statutory warranties that apply to new homes for a certain period of time after they are built (Minn. Stat. ch. 327A). There are three different warranty periods covering three different types of defects when those defects are caused by failure to comply with the State Building Code.

- For one year, the home must be free of defects caused by faulty workmanship or materials.
- For two years, the home must be free of defects caused by faulty installation of heating, cooling, electrical, or plumbing systems.
- For ten years, the home must be free of "major construction defects."

Separate statutory warranties apply to certain home improvements, and those warranties are also found in chapter 327A.

What is the remedy if the warranty is breached?

The consumer may be able to recover in court against the vendor (usually the home builder) for the breach of the warranty, and can recover damages limited to the difference between the home's value with and without the defect, or the amount needed to repair the defect. These statutory warranties are also passed along to subsequent purchasers of the home, but the time limits remain the same.

What does a consumer do if there is a defect?

In order to protect the right to recover under the warranty, the consumer must first notify the vendor of the defect in writing within six months of discovering it or of the time when they should have discovered it, whichever is earlier. The owner must also allow an inspection for the purposes of preparing an offer to repair the alleged loss or damage. Within 15 days of completion of this inspection, the vendor must provide the homeowner with a written offer to repair. The statute lays out minimum requirements for what must be contained in this offer.

If the parties are unable to agree on a scope of repair work, the issue must be referred to the home warranty dispute resolution process contained in statute. A buyer cannot file a lawsuit in district court until either the earlier one of two events occurs and the parties have completed the home warranty dispute resolution process, or 60 days after the written offer of repair is provided to the owner.

The next step would be bringing an action in court. The breach would still have had to occur during the warranty period in order for the remedy to be available, but the consumer can file the action outside the warranty period, provided the action is filed within two years of when the consumer discovers the breach (e.g., if the consumer doesn't discover a hidden defect until after the warranty period has run). This is in addition to the requirement mentioned above that the homeowner notify the vendor within six months of discovering the breach.

Therefore, the homeowner has two separate time limits to deal with after discovering a defect: to notify the vendor within six months and to bring any action in court within two years.

What obligations does the consumer have?

In addition to complying with the relevant time limits for giving notice and filing the action, the consumer must care for the home reasonably so as not to cause damage by negligence or by improper or inadequate maintenance, as these types of damage are not covered. The consumer must also act to minimize any damage that does occur.

What is a "major construction defect" that triggers the ten-year warranty period?

The statute defines a "major construction defect" as "actual damage to the load-bearing portion of the dwelling . . . including damage due to subsidence, expansion or lateral movement of the soil, which affects the load-bearing function and which vitally affects or is imminently likely to vitally affect use of the dwelling or the home improvement for residential purposes." It excludes damage due to windstorms, hail, floods, and other natural disasters.

Do the statutory warranties override other warranty provisions?

No. The law provides that the statutory warranties are in addition to any other warranties that the parties may have agreed to in their contracts or are otherwise provided by law.

Can the statutory warranties be waived by agreement?

The statutory warranties can be waived only where very specific requirements are followed and where, in essence, the vendor provides a substantially similar warranty by agreement. Therefore, the obligation to provide essentially the level of protection called for by statute cannot be waived.

For a major construction defect that is known when the sale is made, the parties can waive the protection as to that specific defect, if:

- it is first disclosed orally;
- it is conspicuously disclosed in the agreement;
- its impact on the value of the home has been appraised and agreed to by the parties; and
- a separate waiver is executed for each known major defect.

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HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: August 2014

Income Tax Terms: Deductions and Credits

What is a deduction?

A deduction reduces income tax liability by reducing taxable income, the amount to which tax rates are applied to determine tax. Federal income tax deductions are commonly divided into two categories:

- Deductions that reduce adjusted gross income (sometimes called **"above-the-line" deductions**) that can be claimed in all cases; and
- **Itemized deductions** that can only be claimed if the taxpayer does not claim the standard deduction (a fixed dollar amount based on filing status).

What federal deductions are allowed?

For tax year 2014, federal above-the-line deductions include ordinary and necessary business expenses, various retirement account contributions, certain employee business expenses, student loan interest payments, Health Savings Account contributions, moving expenses, one-half of self-employment tax, health insurance premiums (for self-employed taxpayers only), penalty on early withdrawal of savings, and alimony paid by the taxpayer. Federal itemized deductions include state and local property taxes and either income or sales taxes, mortgage interest, charitable contributions, medical expenses in excess of 10 percent of income for taxpayers under age 65, and in excess of 7.5 percent for older taxpayers, casualty and theft losses in excess of 10 percent of income, and job expenses and miscellaneous expenses (most only allowed in excess of 2 percent of income).

Are federal deductions allowed at the state level?

Because Minnesota's income tax calculations start with federal taxable income, federal deductions are reflected in Minnesota taxable income. But Minnesota law may nullify some federal deductions by requiring them to be added back to state taxable income.

What state subtractions are allowed?

Minnesota allows its own set of subtractions, including ones for K-12 dependent education expenses, military pay, 50 percent of charitable contributions over $500 (for filers who do not claim federal itemized deductions only), up to $12,000 for low-income elderly and disabled taxpayers with low amounts of Social Security and nontaxable pensions, Job Opportunity Building Zone (JOBZ) income, organ donation expenses, gain on sale of farm property for insolvent taxpayers, foreign subnational income taxes, and national service education awards.

Minnesota also allows subtractions for U.S. bond interest, railroad retirement benefits, and on-reservation earnings of enrolled tribal members, because federal law prohibits state taxation of these types of income.

Finally, Minnesota's income tax allows various subtractions to coordinate the calculation of taxable income with other features of the income tax. Minnesota requires itemizers to add back the amount of state income tax deducted at the federal level and allows a subtraction for amounts refunded in order to avoid twice taxing the same income. Also, Minnesota has not conformed in recent years to federal deductions for bonus depreciation, section 179 expensing, domestic production activities, income from the discharge of indebtedness, and net operating losses. As a result, Minnesota allows subtractions for amounts of these items that were included in Minnesota taxable income, but not federal taxable income, in earlier tax years.

How much are deductions worth?

The value of an income tax deduction equals the taxpayer's marginal rate times the amount of the deduction. A taxpayer whose income is too low to be subject to taxes does not benefit from a deduction, unless the law allows the unused deduction to be carried over to a later tax year.

In tax year 2014, federal marginal rates range from 10 percent to 39.6 percent, and state marginal rates from 5.35 percent to 9.85 percent. The graduated federal and state income tax rates make deductions worth more to high-income taxpayers than to low-income taxpayers. A taxpayer in the top federal and state brackets who claims a $1,000 deduction for moving expenses pays $396 less in federal taxes (39.6 percent of $1,000) and $98.50 less in state taxes (9.85 percent of $1,000). But a taxpayer in the bottom federal and state brackets who claims the same deduction pays $100 less in federal taxes (10 percent of $1,000), and $53.50 less in state taxes (5.35 percent of $1,000).

What is a credit?

Credits are subtracted directly from tax liability. Because credits are subtracted directly from liability, they are worth the same to all taxpayers with liability, regardless of income (i.e., it doesn't matter what tax rate bracket the taxpayer is in).

What is the difference between nonrefundable and refundable credits?

Nonrefundable credits only offset tax liability. Taxpayers with little or no tax liability do not benefit from nonrefundable tax credits.

Refundable credits, in contrast, fully benefit taxpayers regardless of their tax liability. For example, a taxpayer with $700 in tax liability who qualifies for a $1,000 refundable credit would receive a refund of $300. If the credit was nonrefundable, that taxpayer would only be able to "use" the $700 of the tax credit that offset liability.

What federal credits are allowed?

In tax year 2014, the federal income tax allows *nonrefundable* credits for foreign taxes paid, child and dependent care expenses, and retirement contributions of low-income taxpayers. The federal income tax allows *refundable* credits for adoption expenses, certain health coverage expenses, and earned income of lower income filers. The federal child credit, for children younger than 17, and the American Opportunity credit, for postsecondary education expenses, are partially refundable.

What state credits are allowed?

In tax year 2014, Minnesota allows *nonrefundable* credits for marriage penalties resulting from the state's progressive rate structure (marriage credit), long-term care insurance premiums, and military retirement pay of low-income veterans. Minnesota also allows *refundable credits* for earned income of low-income filers (working family credit), dependent care expenses, and K-12 education expenses.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the income tax area on the House Research website for more information on tax credits.

Nina Manzi

Updated: August 2014

The Federal Child Tax Credit

What is the federal child tax credit?

Parents may claim a credit against federal income tax equal to $1,000 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 made permanent by the American Taxpayer Relief Act (ATRA) of 2012.

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 exceeds $149,000; a single parent claiming the credit for one child will become ineligible when income exceeds $94,000.

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 2017, 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 $40,000 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 $1,180 in 2014. They use $1,180 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 $40,000 of their income is from wages, that means they would be eligible to claim up to $5,550 of the remaining credit as a refund (15 percent of $40,000 minus $3,000 equals $5,550). The result is that they claim $1,180 as an offset to their tax liability and are paid the remaining $820 as a refund.

How much do Minnesotans claim?

In tax year 2012, 417,480 federal income tax returns filed by Minnesotans claimed $563 million in the nonrefundable portion of the federal child credit. The average amount claimed was $1,349. For the same year, 244,460 returns filed by Minnesotans claimed $331 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 (the refundable portion) was $1,356.

How does Minnesota compare with other states?

Nationwide, 15.7 percent of all income tax returns claimed the child credit, compared with 15.9 percent in Minnesota. The average amount of the nonrefundable portion claimed nationwide was $1,208, compared with $1,349 in Minnesota. Since the credit is only partly refundable, the larger average amount claimed on Minnesota returns may result from Minnesotans having above-average incomes, and consequently more federal liability available to be offset by the child credit. Utah had the highest average nonrefundable portion, at $1,514, and the District of Columbia had the lowest, at $960.

The average amount of the refundable portion claimed nationwide was $1,340, compared with $1,356 in Minnesota. Utah had the highest average refundable portion, at $1,683, and Massachusetts and Rhode Island had the lowest, at $1,164.

What is the effect of ATRA on Minnesota recipients of the federal child credit?

Some provisions extended by ATRA will expire after tax year 2017, including the provision that decreased the earned income threshold from $10,000, indexed for inflation since 2001, to $3,000, not adjusted for inflation.

Unless Congress extends this provision beyond 2017, in 2018 the portion of the credit that is refundable will revert to being the greater of:

- 15 percent of earned income over $10,000, indexed for inflation since 2001, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

How has the credit amount changed over time?

The credit equaled $400 per child in 1998, increased to $500 in 1999, $600 in 2001 and 2002, and $1,000 beginning in 2003. As noted earlier, the $1,000 credit was made permanent in 2012 by ATRA.

Has the credit always been refundable?

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:

- 15 percent 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; ATRA made the $10,000 as indexed for inflation permanent. The American Recovery and Reinvestment Act of 2009 temporarily reduced the indexed $10,000 to $3,000, not adjusted for inflation, for tax years 2009 and 2010 only; the $3,000 minimum amount has subsequently been extended through 2017.

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HOUSE RESEARCH | Short Subjects

Steve Hinze

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Property Tax 101: Property Tax Variation by Property Type

What causes property taxes to vary by type of property?

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

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

Class Rate Schedule for Taxes Payable in 2015

Class	Property Type (major property types only)	Class Rate	Subject to State Tax?	Subject to Referendum Levies?
1	**Homestead**			
1a	Residential homestead:			
	Up to $500,000	1.00%	No	Yes
	Over $500,000	1.25	No	Yes
2	**Agricultural**			
2a	Agricultural homestead:			
	House, garage & 1 acre – same as residential homestead			
	Agricultural land & buildings:			
	Up to $1,900,000	0.50	No	No
	Over $1,900,000	1.00	No	No
2a	Agricultural nonhomestead	1.00	No	No
2b	Nonhomestead rural vacant land	1.00	No	No
3	**Commercial/Industrial/Public Utility**			
3a	Commercial/Industrial/Public Utility:			
	Up to $150,000	1.50	Yes*	Yes
	Over $150,000	2.00	Yes*	Yes
	Electric generation attached machinery	2.00	No	Yes
4	**Other residential**			
4a	Market-rate apartments (4 or more units)	1.25	No	Yes
4bb	Residential nonhomestead single unit:			
	Up to $500,000	1.00	No	Yes
	Over $500,000	1.25	No	Yes
4b	Residential nonhomestead 2-3 unit and undeveloped land	1.25	No	Yes
4c	Seasonal recreational residential (noncommercial):			
	Up to $500,000	1.00	Yes**	No
	Over $500,000	1.25	Yes**	No
4d	Low-income apartments:			
	Up to $100,000 per unit	0.75	No	Yes
	Over $100,000 per unit	0.25	No	Yes

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

** Subject to state general tax at seasonal recreational rate.

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

Variations also occur because of various property tax exclusions and credits. Homesteads benefit from the homestead market value exclusion, which provides for up to $30,000 of a homestead's market value to be deducted before determining the taxes payable. Other exclusions are the disabled veterans' exclusion and the agricultural "Green Acres" program. Certain types of property also qualify for property tax credits that reduce the net tax on the property. The biggest property tax credit programs are the agricultural market value credit and the taconite homestead credit.

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

What is effective tax rate?

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

Comparison of Property Taxes on Various Types of Property, Within the Same Taxing Jurisdiction, Each with an Estimated Market Value of $200,000 (Property taxes payable in 2015)

Property Type	Class Rate(s)	Net Tax Capacity	Property Tax*		Effective Tax Rate
			Gross	Net	
Agricultural homestead**	0.5/1.0%	$1,200	$1,272	$790	0.39%
Agricultural nonhomestead	1.0	2,000	2,000	2,000	1.00
Residential homestead	1.0	1,808	2,168	2,168	1.08
Seasonal recreational residential (i.e., cabin)	1.0	2,000	2,309	2,309	1.15
Residential nonhomestead (1 unit)	1.0	2,000	2,360	2,360	1.18
Residential nonhomestead (2-3 units)	1.25	2,500	2,860	2,860	1.43
Apartment	1.25	2,500	2,860	2,860	1.43
Low-income apartment	0.75	1,500	1,770	1,770	0.89
Commercial/Industrial	1.5/2.0	3,250	5,235	5,235	2.62
Commercial/Industrial @ $2,000,000***	1.5/2.0	39,250	62,475	62,475	3.12

* These examples assume a total local net tax capacity tax rate of 100 percent, a total market value tax rate of 0.18 percent, a state commercial-industrial tax rate of 50 percent, and a state seasonal recreational tax rate of 20 percent.

** The agricultural homestead is assumed to consist of a house valued at $40,000 and agricultural land and buildings valued at $160,000.

*** This property has a market value of $2,000,000 to show a typical effective tax rate on a larger commercial/industrial property.

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HOUSE RESEARCH | Short Subjects
The Constitution and the Legislature

Joel Michael

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Origination Clause: Bills to Raise Revenues Must Originate in the House

The Minnesota Constitution requires that:

> All bills for raising revenues shall originate in the house of representatives, but the senate may propose and concur with amendments as on other bills. Minn. Const. art. IV § 18.

This provision, commonly referred to as the Origination Clause, is identical to the language of a parallel provision of the United States Constitution. U.S. Const. art. I, § 7, cl. 1. This short subject briefly discusses the types of bills that the Origination Clause requires to begin in the Minnesota House of Representatives.

Two Minnesota appellate court decisions have applied the Origination Clause.

The Minnesota Supreme Court has twice rejected challenges to acts (laws) based on the origination clause. In these two cases, the court held that:

- A bill containing an appropriation was not a bill to raise revenues, even though it may have necessitated imposition of a tax to pay the appropriation. *Curryer v. Merrill*, 25 Minn. 1 (1878).
- A bill imposing civil penalties to abate a nuisance, was not a bill to raise revenues, even though the law specified the penalties were to be collected as taxes. *State ex rel. Robertson v. Wheeler*, 155 N.W. 90 (1913).

In *dicta*, the Minnesota Supreme Court has also said that the clause applies to a bill "whose main purpose is to raise money by taxation." *Curryer v. Merrill*, 25 Minn. 1, 8 (1878). The Minnesota Court of Appeals has also concluded that a regulatory bill that raises more revenue than necessary to pay for the cost of the regulation does not become a bill for raising revenue that must originate in the House. *Investment Company Institute v. Hatch*, 477 N.W.2d 747 (Minn. App. 1991) (statutory construction issue, not a challenge to the constitutionality of the act).

Numerous cases have construed the federal Origination Clause; Minnesota courts likely would follow these cases.

Federal courts have generally read the Origination Clause narrowly. In fact, no act of Congress has been invalidated for a violation of the Origination Clause. The Supreme Court has explicitly reserved the issue of whether it would invalidate acts for violations of the clause in *U.S. v. Munoz-Flores*, 495 U.S. 385 (1991). For example, federal courts have rejected challenges to the Affordable Care Act, which the Supreme Court upheld as an exercise of the congressional power to tax, as violating the Origination Clause. *Sissel v. U.S. Dept. of Health and Human Services*, 2014 WL 3714701 (D.C. Cir. 2014).

The remainder of this short subject describes rules under the Origination Clause derived from federal cases, as well as cases from other states. In construing the state constitution, Minnesota courts are not bound by these federal court decisions applying the federal constitution. However, the decisions are persuasive authority; the Minnesota courts would likely follow them. Some state courts have taken a narrower view of their state origination clauses. Cases from other states are likely to have less persuasive power than federal decisions.

The Origination Clause applies to bills whose principal purpose is to raise "taxes."

As noted above, the Minnesota Supreme Court expressed this principle in *dicta*. *Curryer v. Merrill*, 25 Minn. 1, 8 (1878). Various federal cases have reached similar holdings in rejecting challenges to congressional acts. The decisions have held that the following are *not* bills to raise revenues:

- **Bills that raise revenues (including taxes) but that have another principal purpose** such as establishing a program, *Twin Cities National Bank of New Brighton v. Nebeker*, 167 U.S. 196 (1897)

- **Bills that impose user fees or raise other nontax revenues**, *U.S. v. Munoz-Flores*, 495 U.S. 385 (1991) (did not matter that bill raised more than necessary to fund the program and the excess went to the general treasury)

The Senate may amend a tax bill that originates in the House. The federal courts have permitted this, even when the Senate amendments converted a House bill that reduced taxes into a bill that raised taxes. *Wardell v. U.S.*, 757 F.2d 203 (8th Cir. 1985).

Courts in other states have addressed other Origination Clause issues.

State courts are split on whether bills that authorize borrowing (e.g., issuing bonds) are bills to raise revenues. *Compare Fent v. Oklahoma Capitol Improvement Authority*, 984 P.2d 200 (Okla. 1999) (not revenue raising bill) *and Kervick v. Bontempo*, 150 A.2d 34 (N.J. 1959) (same) *with Morgan v. Murray*, 328 P.2d 644 (Mont. 1958) (bill to raise revenues). The federal courts clearly would not consider bonding authorizations to be bills to raise revenues. The Minnesota courts likely would follow this rule. However, the legislative tradition in Minnesota is to originate state bonding bills in the House. The state's bond counsel generally have insisted on it as a condition for issuing a "clean" bond opinion, since there is no clear Minnesota judicial authority that it is unnecessary.

State courts have generally held that bills authorizing *local governments* to impose taxes are also not bills to raise revenues, on the theory that the limitation applies only to state taxes. *See Yancey & Yancey Construction Co., Inc. v. DeKalb County Commission*, 361 So.2d 4 (Ala. 1978); *Opinion of the Justices*, 233 A.2d 59 (Dela. 1967). Thus, a bill that increases levy limits or grants a local government authority to impose a local sales tax would likely not need to originate in the House. Again, the Minnesota legislative practice has been to originate these bills in the House.

In conclusion, only bills that have a primary purpose of raising state revenues from taxes clearly need to originate in the House. Minnesota practices have been more conservative, however, and have traditionally provided for state bonding bills, bills authorizing local taxes, and bills imposing fees in excess of program costs to originate in the House of Representatives. This technique avoids the possibility of constitutional challenges.

Under its independent authority to interpret and enforce the Origination Clause, the House of Representatives may take a broader view of the clause to protect the House's constitutional prerogatives. The U.S. House of Representatives rejects bills or amendments made by the U.S. Senate as violating the requirements of the clause that likely do not violate the judicial interpretations of the clause's requirements. It does so by passing a "blue slip" resolution and returning the bill to the Senate with a statement that bill violates the Origination Clause. James V. Saturno, *The Origination Clause of the U.S. Constitution: Interpretation and Enforcement* (Congressional Research Service, Mar. 15, 2011).

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

Joel Michael

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Constitutional Restrictions on Taxation of Nonresidents

Since nonresidents can't vote and often are perceived to be high-income investors, they provide a tempting target for raising revenues or for curtailing the cost of tax benefits. Legislators often wish to impose higher taxes on nonresidents or to deny them benefits granted to residents, such as credits or deductions. Tax issues relative to nonresidents often arise in the following contexts:

- Individual income tax on income derived from real property or Minnesota businesses owned by nonresidents
- Income tax on earnings of nonresidents (e.g., professional athletes or entertainers)
- Property tax on vacation homes owned by nonresidents
- Property tax on farms owned by nonresidents

Federal constitutional rules generally require nonresidents to be taxed as favorably as residents. Three constitutional provisions, the Privileges and Immunities Clause, the Commerce Clause, and the Equal Protection Clause, may invalidate differential tax rules for nonresidents. In addition, a nonresident must have sufficient contact with the state to be subject to tax under the due process clause—e.g., a state's income tax can only apply to a nonresident's income from in-state sources.

The Privileges and Immunities Clause provides

> The citizen of each State shall be entitled to all of the Privileges and Immunities of Citizens of the several States. U.S. Const. Art. IV § 2.

The Privilege and Immunities Clause generally prohibits a state from imposing higher tax rates or taxes on nonresidents than it imposes on residents. Although its language refers to "citizens," the Supreme Court has held that provisions discriminating against nonresidents also discriminate against citizens of other states. The clause does not absolutely prohibit discrimination against nonresidents; it permits states to provide different rules for nonresidents if there is a "valid independent reason for" the treatment. Also, it only applies to interests that are "fundamental," i.e., bear on "the vitality of the Nation as a single entity." A fee or tax on pursuing a trade or business is covered. *Toomer v. Witsell,* 334 U.S. 385, 395 (1948). Differential fees on nonresidents for recreational hunting and fishing are not. *Baldwin v. Fish and Game Commission of Montana*, 436 U.S. 371 (1978). In general, differential income or property tax rules are covered, since they affect the right to "reside in" or "to pursue trade, agriculture, [or] professional pursuits." Corporations are not protected by the clause, since they are not considered "citizens."

Examples of laws held to violate the privileges and immunities clause include:

- Denial to nonresidents of personal exemptions and deductions under the individual income tax. *Travis v. Yale & Towne Mfg. Co.,* 252 U.S. 60 (1920). However, these deductions generally may be limited or prorated to be proportionate to the amount of in-state income.
- A "commuter income tax" applying only to nonresidents working in the state. *Austin v. New Hampshire,* 420 U.S. 656 (1975).
- A property tax credit that was limited to farms owned by residents. *Borden v. Selden,* 146 N.W.2d 306 (Iowa 1966).

The Equal Protection Clause. The Equal Protection Clause of the federal constitution prohibits states from denying "the equal protection of the law." Courts use two standards to review laws under the Equal Protection Clause:

- **Strict scrutiny** applies to "suspect classifications" (such as race or religion) or to denial of fundamental rights (such as the right to vote).

- A **rational basis** test applies to all other classifications. Since residency is not a "suspect classification," tax laws that treat nonresidents differentially from residents will be subject to rational basis review. Differential treatment of nonresidents must be rationally related to the state's objective. In general, this gives the legislature considerable flexibility. However, analysis of the Supreme Court decisions suggest that it is not as deferential toward residency classifications as to other nonsuspect classifications, because of the federalism concerns. The Court has explicitly stated it is not doing so, but many legal scholars find this is the only way to explain the results in some cases.

The Court has invalidated laws that distinguish between residents and nonresidents on equal protection grounds. Corporations are also protected by the clause, unlike the Privileges and Immunities Clause. The Court has invalidated:

- An Alaska law that paid rebates to residents, graduated based on how many years they had lived in Alaska, *Zobel v. Williams*, 457 U.S. 55 (1982);
- An Alabama law that taxed out-of-state insurance companies at a higher rate than in-state companies, *Metropolitan Life Insurance Co. v. Ward,* 470 U.S. 869 (1985); and
- A law denying a property tax exemption to an out-of-state charity, *WHYY, Inc. v. Borough of Glassboro*, 393 U.S. 117 (1968).

The Commerce Clause. Although it is a grant of power to Congress, the Supreme Court has held that the Commerce Clause also prohibits states from imposing undue burdens on or interfering with interstate commerce. Provisions that impose higher taxes on nonresidents who conduct business in the state or own property in the state than on residents in the same circumstances will likely be held to unconstitutionally burden interstate commerce. Such provisions will discourage nonresidents from making investments or purchases, restricting or burdening the flow of interstate commerce. Some examples include:

- The Supreme Court has held unconstitutional a Maine law denying a property tax exemption to charitable institutions that primarily serve nonresidents. *Camp Newfound Owatonna, Inc. v. Town of Harrison,* 520 U.S. 564 (1997).
- A number of cases have invalidated imposition of higher taxes or license fees on nonresident "drummers" or solicitors than on residents.

There is little case authority on the extent to which the Commerce Clause restricts a state's ability to tax residents, including determining who qualifies as a resident (e.g., based on presence in or extensiveness of contacts with the state, rather than domiciliary intent to make the state home).

Under any of the constitutional provisions, states generally have more flexibility in limiting benefits under direct spending programs, as compared with tax preferences, to residents. For example, the Court has upheld lower tuition at state higher education institutions for residents, paying bounties for scrap cars, and access to products or services provided by state-run businesses. In part, the Court may be influenced by the fact that these types of benefits are financed mainly by taxes paid by residents and the state needs to restrict access to nonresidents to maintain the economic viability of the programs.

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HOUSE RESEARCH | Short Subjects
The Constitution and the Legislature

Joel Michael

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Taxation and Equal Protection

Both the United States and Minnesota Constitutions prohibit the legislature and state government generally from denying persons the equal protection of the law. The 14th amendment of the United States Constitution provides:

> No state shall * * * deny to any person within its jurisdiction the equal protection of the laws. Art. XIV, § 1.

The Minnesota Constitution contains both a general equal protection clause and a clause requiring uniformity of taxation. Minn. Const. art. I, § 2 (general); art. X, § 1 (uniformity clause).

Most tax laws are subject to "rational basis" review under the Equal Protection Clause; to be constitutional they must simply have a rational relationship to a legitimate legislative purpose.

The Equal Protection Clause was initially adopted primarily to limit or prohibit racial discrimination by the states. The courts have also applied it to proscribe other forms of invidious discrimination (e.g., based on religion, ethnicity, etc.). However, legislation often necessarily involves "discrimination" in the broader sense that groups of individuals or businesses are treated differently based on particular characteristics (e.g., amounts of income, type of business, uses of property, etc.) that in the abstract are unobjectionable. The clause was not intended to restrict legislation that imposed different tax or regulatory rules, for example, on retailers than on manufacturers. Thus, the U.S. Supreme Court has developed a stricter standard of review for laws that create "suspect classifications" or deprive someone of a "fundamental right" as a compared with more benign legislative classifications. The lines between the two categories (perhaps inevitably) blur at the edges. At times the Court has explicitly talked about a middle level of review.

- **Strict scrutiny** applies to "suspect classifications" (such as race or religion) or to denial of fundamental rights (such as the right to vote). The classification is constitutional only if there is a compelling reason for using the classification. If strict scrutiny applies, in most circumstances the classification will be unconstitutional.

- A **rational basis test** applies to economic regulation not involving suspect classifications and, thus, to most of the classifications involved in the tax laws. In general, a classification has a rational basis and is constitutional, if it reasonably related to or has some rational relationship to the objective the legislature sought to achieve. The rational basis test gives the legislature considerable flexibility in creating classifications.

Very few tax statutes have been struck down under the Equal Protection Clause. The U.S. Supreme Court has generally given states wide latitude to fashion tax classifications, perhaps more than in any other area of law. *See San Antonio Independent School District v. Rodriquez*, 411 U.S. 1, 41 (1973), where the Court noted: "[T]hat in taxation, even more than in other fields, legislatures possess the greatest freedom in classification."

Nevertheless, the U.S. Supreme Court has struck down a number of state tax statutes on equal protection grounds. Many (probably most) of these statutes have involved laws that discriminated against nonresidents or out-of-state businesses.

Some examples include:

- Imposing a higher state insurance premium tax on out-of-state insurance companies, *Metropolitan Life Insurance Co. v. Ward,* 470 U.S. 869 (1985);
- Paying rebates to residents, graduated based on how many years they had lived in-state, *Zobel v. Williams*, 457 U.S. 55 (1982);
- Local assessment practice that raised tax valuations to the amount of the sales price but otherwise assessed properties at a fraction of market value, *Allegheny Pittsburgh Coal Co v. County Commission of Webster County*, 488 U.S. 336 (1989). *Compare Nordlinger v. Hahn*, 505 U.S. 1 (1992) (statute that applied a similar rule did not violate equal protection).

The Minnesota Supreme Court has held that the Uniformity Clause of the Minnesota Constitution is no more restrictive than the Equal Protection Clause.

Although the Minnesota Constitution contains a specific clause that requires taxes to be "uniform upon the same class of subject[,]" the Minnesota courts have held repeatedly that this clause is no more restrictive than the Equal Protection Clause. *Reed v. Bjornson*, 253 N.W.2d 102, 105 (upholding the graduated individual income tax) appears to be the first case to establish this rule. The meaning of the Uniformity Clause remains a matter of state law and, thus, a change in the interpretation of the Equal Protection Clause by the U.S. Supreme Court should not be thought to "automatically" change the meaning of the Uniformity Clause. However, the Minnesota courts have fairly consistently followed federal interpretations of the Equal Protection Clause, since *Reed v. Bjornson.*

The Minnesota Supreme Court has set out a three-part test to determine if a tax classification satisfies the Uniformity Clause. *Miller Brewing Co. v. State,* 284 N.W.2d 353, 356 (1979). Under this test:

- The classification must not be "manifestly arbitrary or fanciful but must be genuine and substantial";
- The classification must be "genuine or relevant to the purpose of the law"; and
- The purpose of the statute must be one that the state can legitimately attempt to achieve.

The Minnesota courts have generally been very deferential to legislative tax classifications. In fact, the Minnesota Supreme Court has not struck down a tax statute for violating the Uniformity Clause in the last two decades. Some examples of laws upheld include:

- The limited market value law that taxes otherwise identical properties at different rates based upon how rapidly their values are increasing, *Matter of McCannel*, 301 N.W.2d 190 (Minn. 1980);
- Combined gross receipts gambling tax that imposes a higher tax rate on organizations with more total gross receipts from gambling activities, *Brainerd Area Civic Center v. Commissioner of Revenue*, 499 N.W.2d 468 (Minn. 1993);
- Contamination tax imposing higher property tax rates on polluted property, depending upon whether the owner was a responsible party and whether the owner had entered a response plan, *Westling v. County of Mille Lacs*, 518 N.W.2d 815 (Minn. 1998);
- Fee (35 cents/pack) imposed only on cigarettes manufactured by companies that had not agreed to participate in settlement agreement with the state, *Council of Independent Tobacco Manufacturers of America v. State*, 713 N.W.2d 300 (Minn. 2006).

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Joel Michael

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

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

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

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

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

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

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

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

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

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

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

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

- **The tax will be invalidated, even if discrimination is minor or seemingly inconsequential.** The Court has rejected arguments that the effect of the discrimination is so minor or *de minimus* to not matter.

- **Incentives to encourage local investment or activity may be invalid.** Tax incentives for in-state activity (e.g., investment or exporting) may be invalid, if the net effect is to raise the underlying tax on out-of-state businesses. For example, the Court struck down an income tax credit to encourage businesses to export through in-state corporations. *Westinghouse Electric v. Tully*, 466 U.S. 388 (1984). However, incentives provided through the sales tax (e.g., capital equipment exemptions) or property tax (abatements or tax increment financing) are likely valid, because the underlying taxes apply only to in-state property or transactions. Incentives may be validly provided through direct spending programs (e.g., grants), unless they are linked to a discriminatory tax or other funding source. *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994); *Zenith/Kremer Waste System, Inc. v. Western Lake Superior Sanitary District,* 472 N.W. 2d 300 (1997), *cert. denied* 523 U.S. 1145 (1998).

Discriminatory taxes may be valid as complementary taxes or because they favor government enterprises or activity. Otherwise discriminatory taxes may be valid "complementary" taxes, which offset a specific tax that only a local business or transaction bears. The classic case is the use tax, which complements the sales tax. Sales taxes apply to in-state purchases, but not to purchases made outside the state, such as by phone, mail order, or the Internet. To prevent disadvantaging local merchants, however, the Court upheld a "complementary" use tax, a tax on "using" a product or service in the state. This tax, in effect, only applies to items purchased from out-of-state businesses. But the Court upheld it as a complementary tax. *Hennford v. Silas Mason Co.*, 300 U.S. 577 (1937). It has construed this exception very narrowly, refusing to uphold discriminatory taxes where the argument was made that they offset general local tax burdens.

The Court has upheld provisions that discriminate against interstate commerce where the government is acting as a market participant, rather than imposing regulations or taxes. *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980) (resident preference for state owned cement plant). The Court has extended this to allow discriminatory taxation of interest paid by out-of-state tax-exempt bonds (generally supporting governmental or related activities). *Dept. of Revenue v. Davis*, 553 U.S. 328 (2008).

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Lisa Larson

Updated: September 2014

Federal Accountability and the No Child Left Behind Act Waiver

The No Child Left Behind Act seeks to improve the education outcomes of disadvantaged students

The 2001 No Child Left Behind Act (NCLB) is the federal law that seeks to ensure that all students and specific subgroups of students achieve state reading and math proficiency by 2014. NCLB school improvement requirements apply to high-poverty schools receiving federal Title I funds. The act imposes increasingly severe consequences and redirects the resources of those Title I schools that fail to sufficiently improve students' reading and math proficiency according to a time line. The act also focuses attention on the poor educational outcomes of disadvantaged students.

States were granted federal waivers in exchange for implementing specific reforms

The U.S. Congress has not yet amended and reauthorized the act, which was anticipated to be reauthorized in 2007. In the meantime, and because the need to improve school effectiveness remains, the U.S. Secretary of Education offered to waive certain federal requirements for states, including Minnesota, if those states agreed to implement specific federal reforms.

In 2012, Minnesota was granted a two-year waiver after it agreed to implement the following federal reforms:

- implementing college and career-readiness standards and assessments to measure student achievement and growth
- recognizing high-achieving and high-growth schools and supporting chronically low-achieving schools
- using teacher and principal evaluation and support systems to improve instruction
- reducing duplication and other similar burdens

In exchange for implementing the federal reforms, Minnesota schools do not need to provide supplemental education or transportation services for intradistrict transfers, are not sanctioned for failing to make adequate yearly progress (AYP), and have greater flexibility in allocating Title I funds. The state's NCLB waiver was extended through the 2014-2015 school year.

Minnesota's waiver uses a multiple measures rating (MMR) to focus on the academic achievement gap

Minnesota's waiver replaces the original NCLB goal of achieving 100 percent student proficiency in reading and math by 2014 with a goal of reducing Minnesota's student achievement gap between all students and certain historically underperforming groups of students by 50 percent by 2017. The waiver also replaces the federal AYP measure with an annual multiple measures rating (MMR), based on student academic proficiency and growth measures, school success in reducing the achievement gap for specific student groups, and student graduation rates. The federal MMR measures are distinct from the educational accountability measures—coursework completion, rigorous course taking, student engagement and connection at school—found in Minnesota Statutes.

MMR divides student test data into four proficiency categories

Under the waiver, the MMR ratings divide students' performance on statewide tests into four proficiency categories: does not meet, partially meets, meets, and exceeds standards. Statewide reading and math proficiency targets are set for all students and particular student groups: American Indian; Asian; Hispanic; Black; White; limited English proficiency; special education; and free and reduced price lunch. A school's **proficiency index** is determined by comparing the performance of particular student groups within a school to the established statewide proficiency target for that student group. A school earns points based on the ability of student groups within the school to meet reading and math proficiency targets.

The MMR academic growth score compares students' actual and expected test scores

To determine a school's focus rating, students receive an **academic growth score** based on a comparison between students' actual and expected test scores in reading and math. Students are expected to meet or exceed their expected score, which is based on their test score in the previous school year. Students' individual growth scores in a school are averaged to determine a school growth score. A school earns points based on its success in accelerating students' academic growth.

The MMR focus rating measures a school's ability to close growth and achievement gaps among typically low-performing student groups

The **achievement gap measure** looks at schools' success in accelerating the academic growth for seven typically low-performing student groups: Black; Hispanic; Asian; American Indian; free and reduced price lunch (FRP); limited English proficiency (LEP); and special education. The academic growth for each student group at the school is compared to the statewide average for that student group. The academic growth for the four student groups of color is compared to the statewide average for white students. The academic growth of the three remaining student groups (FRP, LEP, special education) is compared to the statewide average for all students not included in the particular student group. A school earns points based on its success in accelerating the academic growth of these student groups and thereby closing the academic achievement gap among student groups.

The MMR 90 percent graduation rate is the target for all students

The **graduation rate** for all student groups within a school with at least 40 students is compared to a 90 percent high school graduation rate target for all students and particular student groups. A school earns points by demonstrating its ability to meet the 90 percent target graduation rate or by annually improving its graduation rate.

Minnesota must continue to implement specific reforms under its extended waiver

Minnesota applied to renew its federal waiver in February 2014. The extended waiver requires Minnesota to continue to implement specific testing, accountability, and school improvement reforms including, among other items, career and college-ready standards by the 2013-2014 school year, teacher and principal evaluation and support systems by the 2014-2015 school year, and interventions aligned with turnaround principles for schools in the bottom 5 percent of most persistently low-performing schools. If the U.S. Congress reauthorizes NCLB before the waiver period ends, the reauthorization may affect the status of Minnesota's waiver.

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

HOUSE RESEARCH | Short Subjects

Anita Neumann September 2014

Pregnancy and Parenting Leave

The Minnesota Legislature made changes to the laws governing unpaid parental leave in 2014. As part of the Women's Economic Security Act (WESA), the Minnesota law that provided six weeks of unpaid parental leave was extended to 12 weeks and expanded to include leave for pregnancy, childbirth, or related health conditions. (WESA was enacted as Laws 2014, chapter 239.)

What are the details of the leave?

Employers in Minnesota must grant an unpaid leave of absence of up to 12 weeks to an employee who is:

- a biological or adoptive parent in conjunction with the birth or adoption of a child; or
- a female employee for prenatal care, or incapacity due to pregnancy, childbirth, or related health conditions.

An employer may require an employee to give reasonable notice of the date the leave is to begin and the estimated duration of the leave. Minn. Stat. § 181.941.

What employers are covered under the leave law?

The law applies to employers with 21 or more employees at at-least one site. Minn. Stat. § 181.940, subd. 3.

What employees are eligible for pregnancy and parenting leave?

An employee eligible for pregnancy and parenting leave is one who works for the employer from whom the leave is requested for:

- at least 12 months preceding the request for leave; and
- on at least a half-time basis based on the average number of hours worked per week during the 12-month period immediately preceding the leave.

Minn. Stat. § 181.940, subd. 2.

How does the pregnancy and parenting leave work with other types of leave?

The length of pregnancy and parenting leave may be reduced by any paid parental, disability, personal, medical, or sick leave, or accrued vacation provided by the employer so that the total leave does not exceed 12 weeks. The leave may also be reduced by the amount of leave taken for the same purpose under the Federal Family and Medical Leave Act (FMLA). Employers, however, may provide more generous leave policies. Minn. Stat. § 181.943.

HOUSE RESEARCH | **Short Subjects**

Steve Hinze and Andrew Biggerstaff

Updated: September 2014

Property Tax 101: Property Tax Administration

Who does what

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

Assessor

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

Auditor

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

Treasurer

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

Property tax timeline

The process of calculating, imposing, and collecting Minnesota property taxes for a year actually spans two full calendar years. As shown on the reverse side, the two-year cycle begins with the January 2 statutory assessment date and extends all the way through the next calendar year until the property taxes have been paid. For example, for taxes payable in 2015, the cycle begins on January 2, 2014, and doesn't end until the final payments are made in October/November 2015.

Appeal process

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

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

Property Tax System Timeline			
		Assessment Year 2014 Taxes Payable 2015	**Assessment Year 2015 Taxes Payable 2016**
2014	January	Assessment date (2nd)	
	March	Valuation notices mailed	
	April	Local boards of appeal and equalization	
	June	County board of appeal and equalization; state board of equalization	
	July	Certification of state aid amounts	
	September	Truth-in-taxation levy certifications (15th, 30th)	
	November	Truth-in-taxation notices mailed	
	December	Final budget hearings; final levy certifications (27th)	
2015	January	County auditors compute tax rates	Assessment date (2nd)
	March	Property tax statements mailed	Valuation notices mailed
	April		Local boards of appeal and equalization
	May	1st half tax payments due (15th)	
	June		County board of appeal and equalization; state board of equalization
	July	1st half state aid payments made (20th)	Certification of state aid amounts
	September		Truth-in-taxation levy certifications (15th, 30th)
	October	2nd half tax payments due – except on agricultural property (15th)	
	November	2nd half tax payments due – on agricultural property (15th)	Truth-in-taxation notices mailed
	December	2nd half state aid payments made (26th)	Final budget hearings; final levy certifications (27th)
2016	January		County auditors compute tax rates
	March		Property tax statements mailed
	May		1st half tax payments due (15th)
	July		1st half state aid payments made (20th)
	October		2nd half tax payments due – except on agricultural property (15th)
	November		2nd half tax payments due – on agricultural property (15th)
	December		2nd half state aid payments made (26th)

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HOUSE RESEARCH | **Short Subjects**

Bob Eleff

Updated: October 2014

Cable TV Regulation

Regulatory framework

The provision of cable television services is regulated by all three levels of government—federal, state, and local. However, the price of cable services purchased by most households is not regulated at all.

The federal role in cable TV regulation

The Federal Communications Commission (FCC) has developed a set of customer service standards that cable TV providers must follow. These standards govern activities such as billing practices; information cable providers are required to supply to customers; and cable providers' response times to customer complaints, installation requests, and service interruptions. Franchising authorities at the local level are responsible for adopting and enforcing these federal standards.

The FCC also regulates:

- indecency and obscenity in cable TV programming;
- the amount of commercials that may be broadcast during children's programs;
- the maximum fee a municipality may charge a cable TV provider to obtain authority to serve its residents; and
- "signal leakage" that may interfere with other broadcast media.

While in the past the FCC had authority to regulate the price of the most popular cable TV services—expanded cable channel packages, premium movie channels, and pay-per-view sporting events—that authority was revoked by Congress in the Telecommunications Act of 1996. Prices for those services are now unregulated.

The local government role in cable TV regulation

A cable TV provider must obtain authority to serve a community from its local unit of government by negotiating and signing a contract, called a franchise agreement, containing the terms and conditions under which the cable TV provider will operate. In exchange for this franchise, the cable TV provider agrees to pay an annual franchise fee to the municipality, which federal law restricts to a maximum of 5 percent of the annual gross revenues realized by the provider from that community. The agreement also specifies the number of cable channels for local community programming, called PEG (public, educational, and governmental) channels, the provider agrees to provide.

A municipality may regulate the price of basic cable service, and of the equipment and installation needed to provide it, unless the FCC has determined that the cable TV provider is subject to "effective competition" in that market. Basic cable service is the lowest level of service offered, including only local broadcast stations and PEG channels.

The state government role in cable TV regulation

In Minnesota, the state role in regulating cable TV service has been quite limited. State law prohibits a municipality from granting a cable TV provider an exclusive franchise. The statute provides that any competitor must face the same terms and conditions—with respect to the geographical area served, the number of PEG channels required, and fees—as an incumbent provider.

State law also addresses:

- provisions that must be included in franchise agreements, including the minimum number of PEG channels that must be provided;
- the conditions for access to buildings to install and repair cable TV infrastructure;
- the use of public infrastructure for cable facilities;
- the sale or transfer of a cable TV franchise; and
- procedures for extending service to a new area.

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HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: September 2014

Transit Systems in Minnesota

Public transit systems throughout Minnesota vary widely in size, geographic coverage area, and service offerings. While the state assists transit operators with funding and planning, the systems are operated at a local or regional level, primarily by public entities such as counties and cities.

Forms of service

Public transportation systems vary with respect to service provided. The basic forms are:

- **Regular route bus** service, operating primarily in urban settings on fixed routes and standard schedules and typically with frequent stops;
- **Express bus** service (including bus rapid transit), which generally follows longer fixed routes and has fewer stops compared to regular route buses;
- **Rail transit**, which operates on railroad track and includes street cars, light rail transit (LRT), commuter rail, and intercity passenger rail;
- **Demand response or "dial-a-ride,"** in which riders (usually in areas not served by regular route transit) can arrange for specific trips upon request;
- **Route deviation**, bus service on typically regular schedules that generally follows fixed routes but with small deviations upon rider request; and
- **Paratransit**, which provides door-to-door transport for people who are unable to use regular bus service (required under the federal Americans with Disabilities Act (ADA) to complement fixed route bus service areas).

Systems in Greater Minnesota

There are nearly 60 transit systems throughout Greater Minnesota. Each one is classified under state law into one of four categories based on its location and characteristics, as summarized in the table below. Minn. Stat. § 174.24.

Class	Count	Forms of Service	Typical Service Area	Examples
Urbanized	6	Mainly regular route	One or a few cities	Duluth, Moorhead, St. Cloud
Small urban	12	Dial-a-ride, route deviation	One or a few cities	Hibbing, St. Peter, Winona
Rural	39	Dial-a-ride, route deviation	Various	Arrowhead, Becker, Steele
Elderly/disabled	5	Paratransit	Matches regular route	E. Grand Forks, Rochester

Although there are commonalities (especially within each classification), the transit systems vary. Service is most often operated by cities and counties but some systems are run by other forms of local government or nonprofits. Fixed route service and paratransit are only found in more densely populated urban areas. Route deviation or dial-a-ride service, or both, are offered in small urban and rural settings. While transit systems in an urban area typically cover one or a couple of cities, rural systems can cover part of a county, be countywide, or extend across multiple counties. Frequency of bus service varies; it usually covers the working day but can be limited in evening or weekend hours as well as in days of the week.

A number of counties lack countywide transit service, and one (Waseca) does not have transit. Some privately operated (and federally subsidized) intercity bus routes cross transit provider coverage areas and connect more distant cities.

Systems in the Twin Cities metropolitan area

Transit options in the Twin Cities metropolitan area consist of:

- **Metro Transit**, encompassing an extensive bus system as well as the state's only light rail transit line and only commuter rail line;
- **Metro Mobility** paratransit for those with disabilities or health conditions;
- **Transit Link dial-a-ride** minibus or van service for the general public in those parts of the metropolitan area not served by regular route transit;
- **"Opt-out"** systems consisting of seven suburban transit providers that replace Metro Transit service in several cities; and
- **Other operators** such as the University of Minnesota.

The Metropolitan Council

The Metropolitan Council's rail and regular route bus service constitutes the single largest transit system in Minnesota, at about 79 percent of statewide ridership in 2013. The transportation division of the council consists of Metro Transit and Metropolitan Transportation Services (MTS). MTS manages contracts with public and private entities to operate (1) Metro Mobility, (2) Transit Link dial-a-ride service, and (3) additional regular bus routes (mainly for commuter service). In addition, the Metropolitan Council maintains most transit park-and-ride lots and performs regional transportation planning and management.

Opt-outs

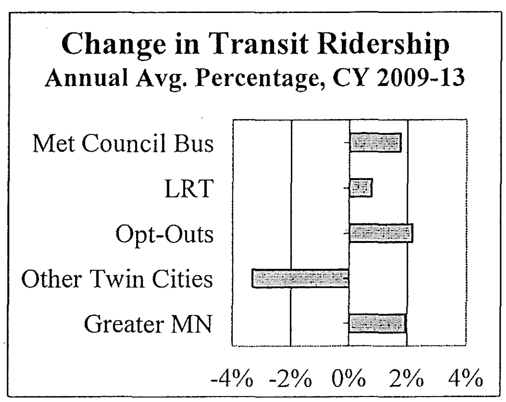
Suburban transit providers, or opt-outs, are operated by a range of agencies including counties and cities (independently or through a joint powers agreement) as well as nonprofits. The service replaces that offered by the Metropolitan Council (although there is some overlap in coverage areas due to commuter service to the central cities). Offerings vary, covering regular route circulator service within specific communities, dial-a-ride, and express buses.

Ridership & growth

Ridership across all transit systems grew by an annual average of 1.4 percent over calendar years 2009 to 2013. The charts below show ridership and average change. (The "other Twin Cities" metropolitan area ridership reduction is likely attributable to Central Corridor LRT construction impacts on University of Minnesota service.)

Category	CY 2013 Ridership	CY 2009-13 Change
Met Council Bus	72.9	4.8
LRT	10.2	0.3
Commuter Rail	0.8	–
Opt-Outs	5.2	0.4
Other Twin Cities	5.3	-0.8
Greater MN	11.9	0.9
Total	**106.2**	**5.6**

Notes
Amounts are in millions.
CY is calendar year.



Note: Chart excludes commuter rail.

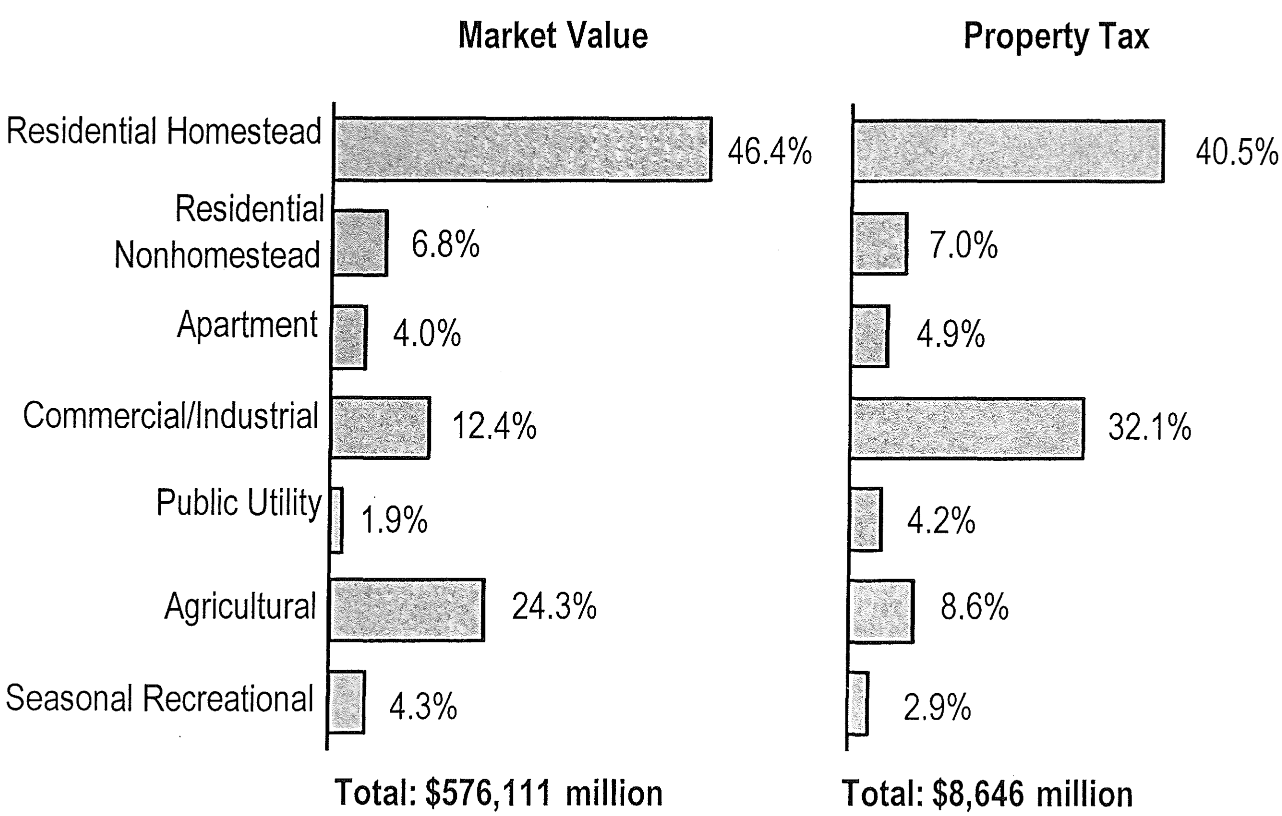
Steve Hinze Updated: October 2014

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

Where property taxes come from

Total property taxes statewide were $8,646 million for calendar year 2014. The total amount of property value (excluding the value of exempt property) was $576,111 million. The graphs below show the breakdown of the state's total market value and total property taxes paid by property type. The differences between the shares of property value and the shares of tax paid result mainly from the state's classified property tax structure, but also from various property tax credit programs, the application of the state general levy and certain voter-approved levies to some property types but not others, and variations in local rates.

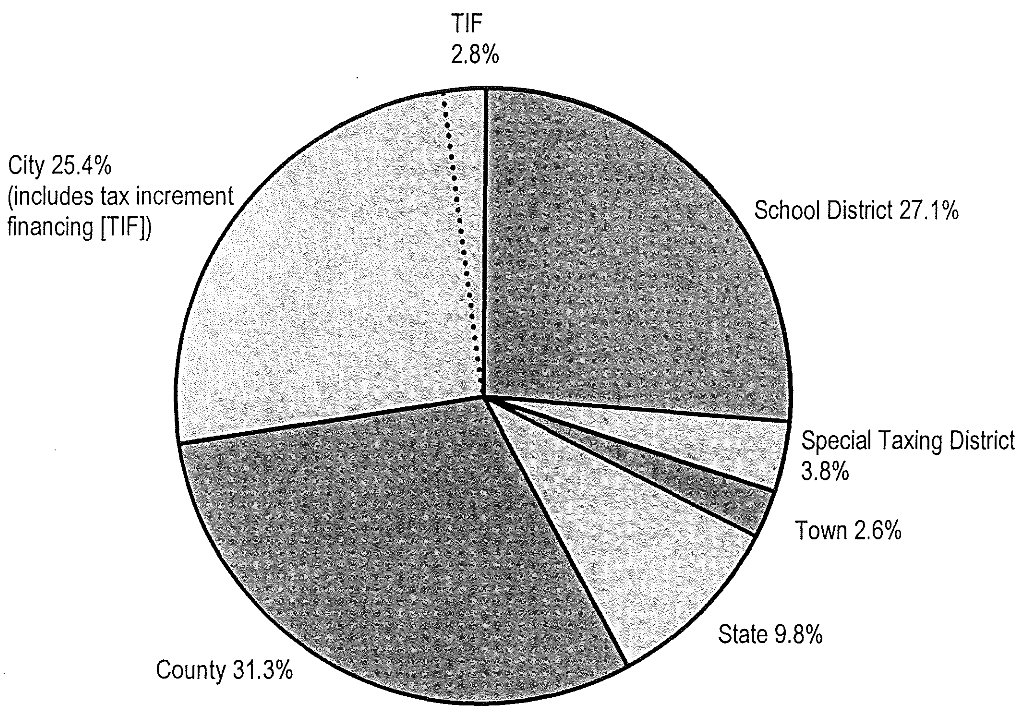
Statewide Shares of Market Value and Property Tax by Property Type (Taxes Payable 2014)



Where property taxes go

The total property tax burden in Minnesota was $8,646 million for calendar year 2014. 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 2014 (Total: $8,646 million)



*Amounts shown are after allocation of property tax credits.

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HOUSE RESEARCH | Short Subjects

Deborah A. Dyson

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"60-Day Rule"
Deadline for Certain Agency Actions

What is the "60-day rule"?

In 1995, the legislature enacted Minnesota Statutes, section 15.99, commonly referred to as "the 60-day rule." The 60-day rule requires governmental entities to approve or deny a written request for certain actions within 60 days or the request is approved. More specifically, "failure of an agency to deny a request within 60 days is approval of the request. If an agency denies the request, it must state in writing the reasons for the denial at the time that it denies the request."

Who does it apply to?

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

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

What requests does it apply to?

It applies to "a written request relating to zoning, septic systems, watershed district review, soil and water conservation district review, or expansion of the metropolitan urban service area for a permit, license, or other governmental approval of an action." It also includes an application to a heritage-preservation commission for a certificate of appropriateness. *500 LLC v. City of Minneapolis*, 837 N.W.2d 287 (Minn. 2013). A "request" is a written application on a form provided by the agency, if a form exists. A request not on an agency's form must include all information required by the agency and identify clearly on the first page the specific permit, license, or other governmental approval being sought.

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

When does the time begin to run?

The 60 days begins to run when the agency receives a complete application. If an application needs to be amended, the 60 days begins again upon receipt of a complete amended application. *Tollefson Dev. Co. v. City of Elk River*, 665 N.W.2d 554 (Minn. App. 2003). The application fee, if any, is one of the items that must be paid before an application is complete. The agency has 15 business days after receiving any part of an application to inform an applicant in writing that the application is missing some required element. If more than one state agency in the executive branch must approve or deny the application, the 60 days begins to run when the first agency receives the complete application, and it is up to that agency to make sure all other agencies get copies of the application. If an agency grants a conditional approval, the agency may revoke or rescind its approval without missing the 60-day deadline if the applicant fails to satisfy the conditions.

Are extensions allowed?

An agency may extend the review period by up to 60 days if it provides the applicant written notice of and reasons for the extension before the end of the initial 60 days. The notice of extension must be made after the complete application is submitted and the initial 60 days has begun to run. An agency does not have to have extenuating circumstances to extend the review time; it is enough that the agency needs more time. *American Tower, L.P. v. City of Grant*, 636 N.W.2d 309, 313-314 (Minn. 2001). The law also takes into account other proceedings or federal law requirements that may delay the beginning of the 60-day period. *E.g., Allen v. City of Mendota Heights,* 694 N.W.2d 799 (Minn. App. 2005) (environmental review initiated by a citizens' petition under Minnesota Environmental Policy Act). An applicant may request an extension of time in writing. An interim ordinance (moratorium) does not extend the time for agency action as to an application filed before the effective date of the interim ordinance.

How does an agency approve a request?

A request can be approved by the agency in its customary manner or by failing to deny the request within the 60-day period. An agency can only approve a request to the extent of its authority under other law. *Breza v. City of Minnetrista*, 725 N.W.2d 106 (Minn. 2006).

How does an agency deny a request?

If an agency other than one with a multimember governing body denies a request, it must state in writing the reasons for the denial at the time it denies the request. A multimember governing body may deny a request by adopting a resolution or motion to deny the request, or failing to adopt a resolution or motion to approve a request. The governing body must provide its reason for denial on the record at the time of the vote on the resolution or motion. It must also provide a written statement of reasons for the denial to the applicant before the expiration of the time allowed for a decision. The written statement must be consistent with the reasons stated at the time of the decision.

While failure to approve or deny a request results in approval, failure to timely provide the applicant with a written statement of the reasons for denial does not result in automatic approval. *Johnson v. Cook County*, 786 N.W.2d 291, 295-96 (Minn. 2010), citing *Hans Hagen Homes, Inc. v. City of Minnetrista*, 728 N.W. 2d 536 (Minn. 2007) (en banc) (describing the difference between "directory" and "mandatory" requirements in statute, determining that the requirement to provide an applicant with a copy of the written reasons for denial was directory and because city had stated reason for denial on the record within the time allowed, the failure to provide a written statement did not result in automatic approval). "[A] statute may contain a requirement but provide no consequence for noncompliance, in which case we regard the statute as directory, not mandatory." *Hans Hagen Homes, Inc.,* 728 N.W.2d at 541-42.

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

HOUSE RESEARCH | Short Subjects

Anita Neumann October 2014

Pregnancy Accommodation

The Women's Economic Security Act (WESA), enacted in 2014, requires employers to provide reasonable accommodation at the request of a pregnant employee for health conditions related to pregnancy or childbirth. The basic elements of the accommodation provisions of the new law, Minnesota Statutes, section 181.9414, are discussed below.

What does the law require?

Upon request of a female employee, employers must provide reasonable accommodation for health conditions that are related to pregnancy or childbirth. An employer may request the advice of the employee's licensed health care provider, including a certified doula, in providing the accommodation.

An employer cannot require an employee to take a leave or accept an accommodation or retaliate against an employee for requesting or obtaining an accommodation.

What is reasonable accommodation?

Reasonable accommodation includes, but is not limited to:

- temporary transfer to a less strenuous or hazardous position;
- seating;
- frequent restroom breaks; and
- limits on heavy lifting.

The law, however, specifies that an employer is not required to do any of the following in order to provide accommodation:

- create a new or additional position
- transfer an employee with greater seniority
- discharge any employee
- promote any employee

Are there exceptions to the requirement to provide reasonable accommodation?

Reasonable accommodation need not be provided if an employer can demonstrate that the accommodation would impose undue hardship on the operation of the business.

This exception, however, does not apply to, nor can an employer require the advice of a licensed health care provider or certified doula, for the following accommodations:

- more frequent restroom, food, and water breaks
- seating
- limits on lifting over 20 pounds

What employers does this apply to? Pregnancy accommodation must be provided by employers with 21 or more employees at at-least one site.

HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff and Deborah Dyson **Updated: October 2014**

Special Assessments: An Overview

What are special assessments?

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

What can special assessments be used for?

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

How is the amount of a special assessment determined?

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

How are special assessments imposed?

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

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

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

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

Can special assessments be deferred or delayed?

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

How are special assessments different from property taxes?

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

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

Who imposes most special assessments and what are the trends?

In 2012, over 80 percent of all special assessments were collected by cities ($196.4 of the $239.5 million total by cities, counties, and towns). City use of and revenue from special assessments have decreased 29.8 percent from 2003 to 2012. As a percentage of total city revenue, special assessments decreased from 7.3 percent to 5.6 percent (in constant dollars). In the same time period, total city revenues decreased by 9.2 percent (in constant dollars).

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

Cities and urban towns may impose by ordinance charges to pay for certain services that often are paid for with general revenues (e.g., property taxes). In addition, they may adopt an ordinance to collect unpaid charges imposed on an individual property using the special assessment collection process. Minnesota Statutes, section 429.101, lists the services that can be paid for as if they are special assessments without regard to the benefit test.

For more information: Contact legislative analyst Andrew Biggerstaff, at andrew.biggerstaff@house.mn, or Deborah Dyson at deborah.dyson@house.mn.

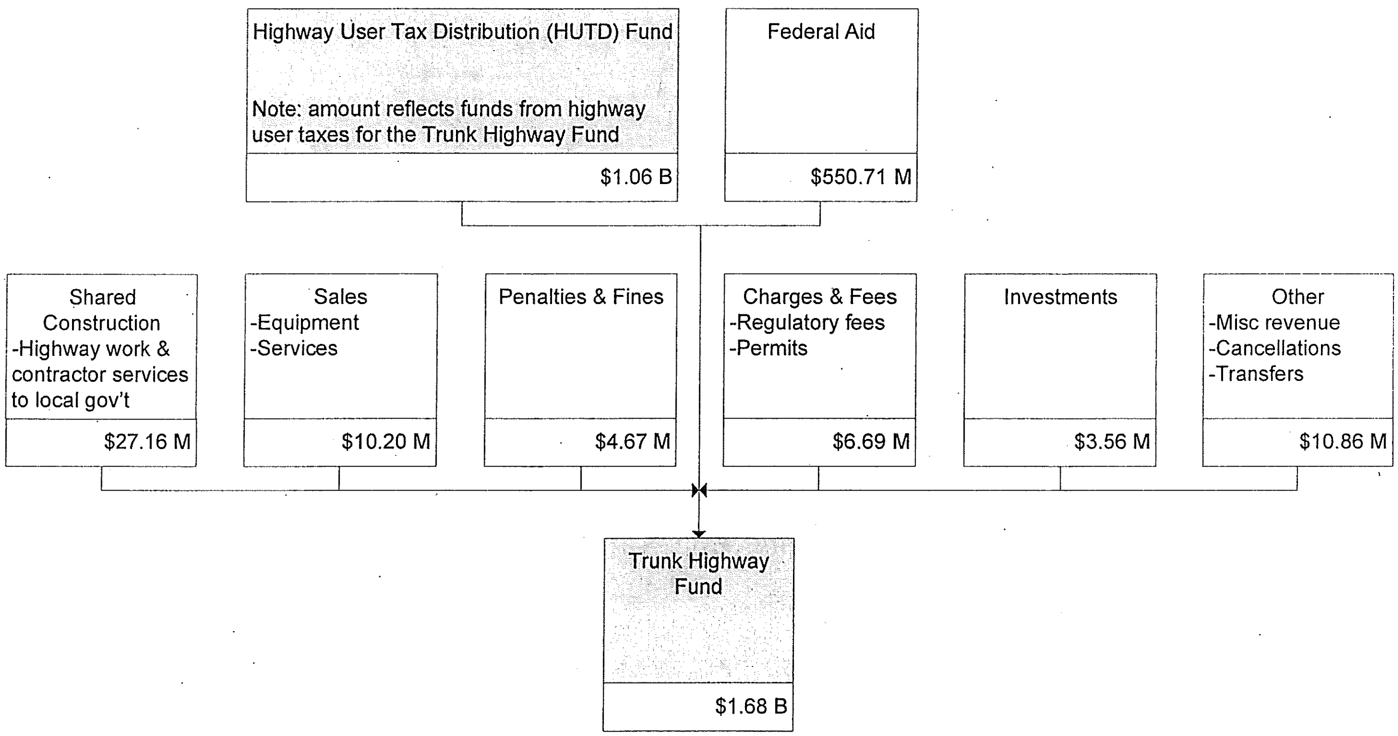
The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

HOUSE RESEARCH | Short Subjects

Matt Burress Updated: October 2014

Trunk Highway System

The trunk highway system is a roughly 12,000-mile network of key roads connecting communities throughout the state, maintained by the Minnesota Department of Transportation (MnDOT). It includes the interstate and U.S. highway systems as well as other state highways. The bulk of funding for the system comes from transportation-related taxes and federal aid. Fiscal year 2013 funding for the trunk highway system, amounting to $1.68 billion (excluding trunk highway bond proceeds), is summarized below.



Funding framework Funding is based on a highway finance framework established by the Minnesota Constitution, which includes dedication of funding through three transportation-related taxes and allocation of the tax revenues. Minn. Const. art. XIV.

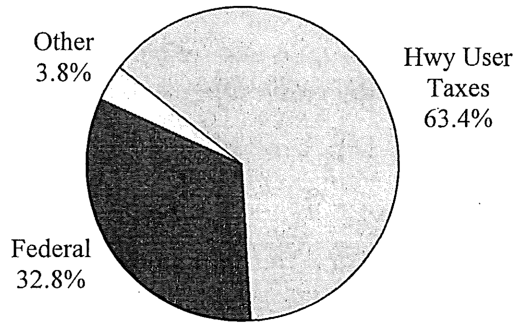
Primary sources The primary state sources of trunk highway revenue are three highway user taxes: a tax on motor fuels, a registration tax on motor vehicles, and a tax on the sale of motor vehicles (all allocated from the highway user tax distribution fund). Federal aid constitutes another significant source.

Trunk highway bonds Trunk highway bonds are a specialized form of general obligation bonding, issued by the state only for construction on the trunk highway system (following constitutional requirements). Minn. Const. arts. XI, § 5 (e); XIV, § 11. Since bonds carry an obligation for future repayment with interest, proceeds from bond issuances represent debt rather than "new" revenue. Nonetheless, proceeds from bonds sales can be viewed as a specialized funding source.

In fiscal year 2013, $212.8 million in bond proceeds went to the trunk highway system. This amount only represents funds *expended* in that fiscal year. Legislative bond *authorizations* available in fiscal year 2013 are higher because much of the bond proceeds are committed to projects in which a portion of actual expenditures will not take place until future fiscal years. (Bonds are issued based on cash flow needs of authorized projects, in amounts designed to cover upcoming costs until a subsequent bond sale).

Distribution of funding sources

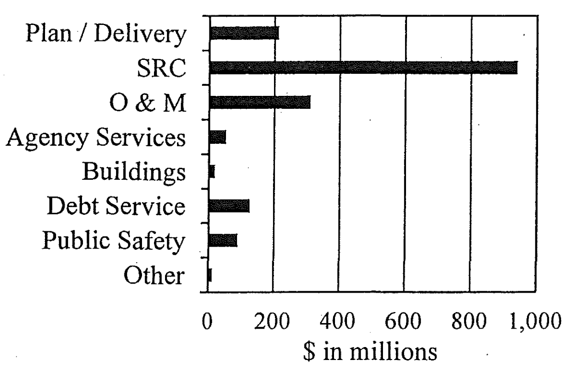
Distribution of Trunk Highway Funding
FY 2013 ($1.68 billion)



Expenditures

The following summarizes trunk highway fund expenditures by budget activity.

Trunk Highway System Expenditures
FY 2013 ($1.77 billion)



- **Program planning and delivery** mainly involves three elements: (1) project development to prepare a project for construction through tasks like scoping, engineering, and environmental analysis; (2) project management, which involves oversight of specific projects; and (3) general statewide system planning.
- **State road construction (SRC)** is the largest category, funding specific construction projects. Its main components are (1) contracts and consultant agreements for actual construction work, (2) materials purchasing, and (3) right-of-way acquisition.
- **Operations and maintenance (O & M)** provides for snowplowing and road clearance as well as ongoing items like roadway repairs, maintaining traffic safety infrastructure (such as guard rails and signs), and day-to-day preservation of MnDOT facilities.
- **Agency services** includes departmental leadership, finance, information technology, and human resources.
- **Buildings** is for larger facilities construction projects.
- **Debt service** is repayment of principal and interest on trunk highway bonds (issued in previous years).
- **Public safety** primarily funds the State Patrol.

For more information: Contact legislative analyst Matt Burress at 651-296-5045. Also see the House Research publication *Highway Finance*, October 2014.

Rebecca Pirius

Updated: October 2014

Judicial Branch Overview

Court Structure

There are three court levels in Minnesota: district court, court of appeals, and Minnesota Supreme Court. Minnesota has ten judicial districts that contain all district courts in the state. There is also a federal trial court for Minnesota, which is called the District Court for Minnesota.

Key Responsibilities and Jurisdiction of the Courts

District Court: The district or trial court interprets the law and applies it to the facts of specific cases. District courts may hear criminal, civil, probate, juvenile, or family law cases. The district court can also hear appeals from conciliation court (civil disputes involving less than $15,000). There are 289 district court judges.

Court of Appeals: The 19 judges on the court of appeals review district court decisions for errors of law and sufficiency of evidence to support the verdict.

The court of appeals also:

- Reviews the validity of administrative rules and hears contested case appeals under the Administrative Procedures Act;
- Issues writs requiring district judges or public officials to take specified actions; and
- Adopts its own supplementary rules of procedure consistent with Supreme Court rules.

Minnesota Supreme Court: The seven justices of the supreme court hear the following:

- Criminal and civil appeals from the district courts and the court of appeals
- Appeals from the Workers' Compensation Court of Appeals and the Tax Court
- Important original actions provided by statute
- Writs requiring trial judges or public officials to take or refrain from taking specified action

The Minnesota Supreme Court also regulates lower courts, regulates attorneys, and oversees certain bodies involved in legal aid and public defense.

Special Statutory Courts

The Tax Court and Workers' Compensation Court of Appeals are executive branch agencies created by statute to deal with the specific areas of law that are reflected in their names.

Differences Between State and Federal Court

Cases Originating in State Trial Court: The first appeal is to the court of appeals and/or the Minnesota Supreme Court if the case concerns first-degree murder or legislative and statewide election contests.

If the case includes a claim that the United States Constitution has been violated, it can be further appealed to the United States Supreme Court.

Cases Originating in Federal Trial Court: Federal trials are generally held in Minneapolis or St. Paul. The kinds of cases heard include:

- federal statutory claims (criminal or civil);
- federal constitutional claims (criminal or civil); and
- any suit between a Minnesota resident or entity and a resident or entity from another state, involving a minimum amount of $75,000 in damages.

Appeals go to the Eighth Circuit Court of Appeals in St. Louis, Missouri, but cases are heard in St. Paul. Appeals from Eighth Circuit decisions go to the United States Supreme Court.

Relationship Between Judiciary and Legislature

The legislative and judicial branches are co-equal. When lawsuits involve statutes, courts try to explain and enforce the legislature's intent, unless the statutes are found to violate the state or federal constitution.

The legislature has power, through the state constitution, over the state's courts in areas such as: how the court is established, abolishment of courts, the size of the court, judicial salaries, which cases the court may and may not hear, and how long judges can serve. The Supreme Court has authority over procedural issues necessary for courts to function.

For more information: Contact legislative analyst Rebecca Pirius at 651-296-5044. Also see the House Research publication *The Minnesota Judiciary*, May 2014.

Jamie Olson **Updated: October 2014**

The Minnesota Newborn Screening Programs

The Minnesota Newborn Screening Programs, updated in 2014, are public health programs through which all infants born in the state are screened for a variety of disorders. The Newborn Screening Program, which uses genetic information to screen for more than 50 disorders, is governed by Minnesota Statutes, sections 144.125 and 144.128. The Early Hearing Detection and Intervention program, though which infants are tested for hearing loss, is governed by Minnesota Statutes, section 144.966, and the screening for critical congenital heart disease is governed by Minnesota Statutes, section 144.1251.

Infants are screened for more than 50 genetic disorders

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

- amino acid disorders,
- fatty acid oxidation disorders,
- organic acid disorders, and
- endocrine disorders.

(For a full list of the disorders, see the MDH website, http://www.health.state.mn.us/divs/phl/newborn/materials/factsheets/disorderpanel.pdf.

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

- making certain information and forms related to storage of blood samples and test results are available to health care providers and parents
- notifying newborns' physicians of the results of the screen
- making referrals for the necessary treatment of diagnosed cases of heritable and congenital disorders when treatment is indicated
- maintaining a registry of the cases of disorders detected for the purpose of follow-up services

Expansion of the program

The legislature has expanded the program in recent years. A law passed in 2007 required all hospitals to establish an Early Hearing Detection and Intervention (EHDI) program. In 2013, the legislature enacted a law that required all hospitals to test newborns for critical congenital heart disease.

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

Generally, consent for newborn screening is presumed unless parents object to the screening in writing by specifying that they want their child to opt out of the screening. Parents will be notified that they have the option to opt out of the tests being performed or have the tests performed without the results stored.

Prior to collecting a sample, persons with a duty to perform testing under the Newborn Screening Program must inform parents of the following:

- the benefits of newborn screening
- that parents have the right to decline to have newborn screening performed and that they may secure private testing
- that the blood samples and test results may be stored by MDH unless the parent elects against storage
- that parents have the right to have the tests performed but not have the blood samples or test results stored
- that parents have the right to authorize, in writing, that results may be used for public health studies or research
- the MDH website where more information may be found

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

The 2006 Legislature passed a law governing the treatment of genetic information held by state government. Minnesota Statues, section 13.386, subdivision 3, requires that, unless provided in law, genetic information about an individual may be collected by the government with the written, informed consent of the individual. The genetic information may be used only for the purposes and stored for the period of time to which the individual consented. Also, the genetic information may be disseminated only with the individual's written, informed consent, or as necessary to accomplish the purposes of the collection.

In November 2011, the Minnesota Supreme Court ruled on this issue in *Bearder v. State of Minnesota* (806 N.W. 2d 766, November 16, 2011), which challenged certain MDH activities related to the newborn screening programs in light of the genetic privacy law (Minn. Stat. § 13.386). The state Supreme Court found that the genetic privacy law does generally apply to blood samples collected under the newborn screening program; however, there are narrow exceptions provided in statute that authorize MDH to administer the newborn screening tests of blood samples, record and report those test results, maintain a registry of positive cases, and store those test results as required by federal law.

In 2014, the newborn screening laws were amended to allow stored blood samples and tests results to be used for studies related to newborn screening, including studies used to develop new tests. The law prohibits use of the blood samples and test results for any other reason than allowed under the law without the written consent of the parent. The law also prohibits the sale of bloodspots, test results, or other data collected during the newborn screening process.

The law now also allows, in addition to parents, a person who was tested under the newborn screening program, once that person is 18 years or older, to request the blood samples and test results destroyed. Once a parent or person who was tested requests the blood samples or test results be destroyed, the results must be destroyed within a certain time period, as provided in law.

For more information: Contact legislative analyst Jamie Olson at 651-296-5403. Also see the House Research publication *Genetic Privacy Law and the Bearder Case*, September 2013.

HOUSE RESEARCH | Short Subjects

Lisa Larson

Updated: October 2014

Access to Student Records

Schools collect a lot of student information

Schools collect a lot of information about students. School records often contain detailed information about a student's health and physical condition, aptitude scores, achievement and psychological tests, comments by school counselors and teachers, notes on interviews with parents and students, reports by social workers, delinquency reports, samples of students' work, and autobiographies. Some records may indicate a student's race, religion, and national origin or include completed questionnaires for research projects.

Federal Family Educational Rights and Privacy Act protects the privacy of students' education records

The Federal Family Educational Rights and Privacy Act (FERPA) generally provides that education data in students' records are private, and parents largely control access to the data. Parents' rights regarding their children's records often transfer to the student at age 18. However, a school may disclose information from an eligible student's record to the parent of the student if the student remains a dependent for tax purposes. Schools must notify parents and students of their rights under the law. FERPA allows schools to disclose education data without parents' consent under some circumstances. It sets minimum data practices standards that states may make more stringent if there is no conflict with federal law. FERPA applies to all public and private K-12 schools and postsecondary institutions that receive applicable federal education funds, and schools that violate FERPA can lose their funds. Individuals cannot sue under the act.

Parents must consent to disclosing students' records

FERPA generally prohibits schools from disclosing education records or other personally identifiable information about a minor student without the parent's written consent. An effective written consent requires the parent to state that the student's education record may be disclosed, the purpose of disclosing the record, and the person(s) to whom the disclosure may be made. A parent may consent to release the education records of a minor student to anyone the parent indicates.

Parents may inspect and review students' records

FERPA gives parents the right to inspect and review their students' education records. School districts annually must publish and distribute or post the procedures by which parents may access a student's records. Schools need not provide copies of materials in education records unless a parent cannot inspect the records personally. Schools may charge a fee for providing copies of records.

Parents may ask a school to correct inaccurate records

FERPA allows parents to ask a school to correct education records they believe are inaccurate or misleading. If the school refuses to change the records, parents have the right to a formal hearing. If the school refuses to correct the records after the hearing, a parent may place written comments about the contested information in the records.

Schools may disclose records without consent if a statutory exception applies

FERPA allows schools to disclose education records without parents' consent to:

- school officials in the student's school district who have a legitimate educational interest in the information
- another school to which a student is transferring
- parents when a student over 18 is still a dependent
- certain government officials in order to carry out lawful functions
- appropriate parties in connection with financial aid to a student
- organizations doing certain studies for the school
- accrediting organizations
- individuals who have obtained court orders
- persons who need to know in cases of health or safety emergencies
- juvenile justice system

Schools may disclose directory information to anyone

Examples of directory information include a student's name, address, and telephone number. Schools may disclose directory information to anyone without a parent's consent. Schools decide what information to designate as directory information. Schools must tell parents that they can refuse to let the school designate information about their student as directory information. A school may not charge for access to directory information but may charge for a copy of the information.

The Government Data Practices Act regulates data practices in Minnesota

FERPA sets only minimum data practices standards and allows states to enact more stringent laws that do not conflict with FERPA. The Minnesota Government Data Practices Act under Minnesota Statutes, chapter 13, also regulates government practices involving data. Minnesota law adopts FERPA provisions and includes some additional restrictions and requirements on the sharing of educational data. Under the data practices law, "educational data" is "private data on individuals" and is available only to its subject, the student. Schools cannot disclose education records or other personally identifiable information unless a sufficiently mature student or the student's parent gives written consent or a federal or state exception applies.

There are several differences between federal and state law

The Minnesota Government Data Practices Act differs from FERPA in several ways, by:

- requiring a school to give its students a warning, often called the Tennessen warning, any time it collects private or confidential data about the student
- allowing a minor student to give informed consent to disclose educational data in some circumstances
- allowing a minor student to request that a school deny the student's parents access to educational data about the student
- releasing education records subject to a court order but not a subpoena
- prohibiting parents from inspecting teachers' desk notes but allowing parents to inspect the desk notes of other school personnel
- allowing parents to designate an additional person to participate in school conferences about a minor student

For more information: Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research publication *Federal and State Laws Governing Access to Student Records*, November 2000.

HOUSE RESEARCH | Short Subjects

Randall Chun

Updated: November 2014

MinnesotaCare: An Overview

MinnesotaCare is a federal-state program that provides subsidized health care coverage to low-income individuals. The program is administered by the Department of Human Services (DHS). DHS, in cooperation with MNsure, the state's health insurance exchange, is responsible for processing applications and determining eligibility.

Eligibility

Most MinnesotaCare enrollees are parents and caretakers, children ages 19 to 20, and adults without children.

To be eligible for MinnesotaCare, an individual must meet the following criteria:

- Have gross income that is greater than 133 percent of the federal poverty guidelines (FPG) ($15,521 for a household of one) but does not exceed 200 percent of FPG ($22,980 for a household of one). Exceptions to the income floor are made for certain children under age 19 and legal noncitizens, who are not eligible for MA.
- Not be eligible for Medical Assistance (MA). This requirement has the effect of shifting the vast majority of pregnant women and children from MinnesotaCare to MA.
- Not have access to subsidized health coverage that, as defined in the federal Affordable Care Act (ACA), is affordable (the employee pays no more than 9.5 percent of income for self-only coverage) and provides minimum value (pays for at least 60 percent of medical expenses on average).
- Not have minimum essential health coverage (defined in the ACA as coverage under Medicare, Medicaid and other government programs, employer-sponsored coverage, individual market coverage, and other specified coverage).
- Be a resident of Minnesota. Enrollees must meet the residency requirements of the MA program.

Covered services

Parents and caretakers and adults without children are covered for most, but not all, services covered under MA. Covered services include physician care, hospitalization, prescription drugs, therapy services, and a wide range of other health care services. 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.

Children ages 19 and 20, and certain children under age 19, receive coverage for a broader range of services than adults.

Premiums and cost-sharing	Enrollees age 21 and older pay monthly, per-person premiums based on a sliding scale. Persons under age 21 are not charged premiums. Adult enrollees are subject to copayments and other cost-sharing for specified services.
Provider reimbursement	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.
MinnesotaCare as Basic Health Program	Under the ACA, states have the option of operating a basic health program to provide health coverage to persons with incomes greater than 133 percent but not exceeding 200 percent of FPG, beginning January 1, 2015. The 2013 Legislature directed DHS to seek federal approval to operate MinnesotaCare as a basic health program. The legislature also made changes in MinnesotaCare eligibility, covered services, and service delivery that are consistent with federal requirements for a basic health program; many of these changes took effect January 1, 2014.
Expenditures and funding	In fiscal year 2013, the MinnesotaCare program paid $570 million for medical services provided to enrollees. Forty-nine percent of this cost was paid for by the state, 44 percent by the federal government, and 7 percent by enrollees through premium payments (this last category also includes enrollee cost-sharing). The state receives federal funding at the MA match rate for health care services provided to enrollees under a federal waiver. Once federal approval to operate MinnesotaCare as a basic health program is obtained, the state expects to receive from the federal government a payment for each enrollee equal to 95 percent of the subsidy that the individual would have otherwise received through MNsure. State funding for MinnesotaCare and other health care access initiatives is provided by a tax of 2 percent on the gross revenues of health care providers and a tax of 1 percent on the premiums of nonprofit health plan companies. The tax on health care provider revenues is scheduled to sunset January 1, 2020. Prior to that date, the Commissioner of Management and Budget is required to reduce the rate of the tax on health care provider revenues if certain financial criteria are met.
Recipients	As of June 2014, 54,956 individuals were enrolled in the MinnesotaCare program. Just over one-half of these enrollees were adults without children.
Application procedure	MinnesotaCare applications can be obtained by calling the Department of Human Services (1-800-657-3672) or MNsure, the state's health insurance exchange (1-855-366-7873). Applications are also available at county human services agencies and other locations.

For more information: See the House Research information brief *MinnesotaCare*.

Randall Chun Updated: November 2014

Medical Assistance: An Overview

Medical Assistance (MA), the state's Medicaid program, is a federal-state program that pays for health care services for low-income individuals. The program is administered 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 any applicable asset limits. Certain types of income and specified assets are excluded when determining eligibility. Income and asset limits for selected groups are described below.
- Be a U.S. citizen or a noncitizen who meets specified immigration criteria.
- Be a resident of Minnesota.
- Meet other program eligibility requirements.

Eligibility group	Net income limit, as % of federal poverty guidelines (FPG)	Asset limit*
Children < age 2	283	None
Children 2 through 18	275	None
Children 19 through 20	133	None
Pregnant women	278	None
Parents and caretakers	133	None, unless on spenddown
Aged, blind, or disabled	100	$3,000 for one/$6,000 for two/$200 each additional
Adults without children	133	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 133 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.

Medicaid expansion and other 2013 session changes	The 2013 Legislature made a number of changes in MA eligibility related to the federal Affordable Care Act (ACA). These changes included raising the income limit and requiring the use of modified adjusted gross income (MAGI) and a standard 5 percent income disregard when determining eligibility for certain groups, and eliminating the asset requirement for parents and caretakers.
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 home and community-based "waivered services" not normally covered by Medicaid that are intended to allow 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 state fiscal year 2013, total state and federal MA expenditures for services were $8.045 billion. The federal share of MA costs is determined by a formula based on state per capita income. In most fiscal years, the federal government has paid 50 percent of the cost of MA services, with Minnesota responsible for the remaining 50 percent. The federal government is providing an enhanced federal match, initially 100 percent of the cost of services and phasing down to 90 percent, for services provided to adults without children.
Recipients	During state fiscal year 2013, an average of 738,084 individuals were eligible for MA services each month. As of July 2014, 714,414 MA recipients received services through the MA managed care system, with the remaining enrollees served through fee-for-service.
Application procedure	Individuals interested in applying for MA should contact their county human services agency or MNsure, the state's health insurance exchange.

For more information: See the House Research information brief *Medical Assistance*.

Nina Manzi and Lisa Larson

Updated: November 2014

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 allows up to $2,500 to be deducted for each dependent in grades 7-12 and up to $1,625 for each dependent in grades K-6.

In tax year 2013 (fiscal year 2014) an estimated 216,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will cost the state $19.0 million in tax year 2015 (fiscal year 2016).

What expenses qualify for the deduction?

Qualifying expenses for the deduction include payments for:

- 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 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 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 2012, 53,516 Minnesotans claimed a total of $14.7 million in K-12 education credits. The average credit was $276. In tax year 2015 (fiscal year 2016), the Department of Revenue estimates that Minnesota will claim $12.0 million in K-12 education credits.

What expenses qualify for the credit?

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

What are the tax benefits of the deduction and credit?

The deduction reduces an individual's taxable income. The tax benefit of the deduction depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has four marginal tax rates: 5.35, 7.05, 7.85, and 9.85 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 9.85 percent bracket with the same deduction will pay $246.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2015, a typical married couple with two dependents would need to have $28,600 of gross income before owing any state income tax.

The credit, in contrast, 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-1M, income additions and subtractions. 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, 14 states in addition to Minnesota provide income tax benefits for education-related expenses. **Alabama, Arizona, Florida, Georgia, Indiana, Iowa, Kansas, Louisiana, New Hampshire, Oklahoma, Pennsylvania, Rhode Island, South Carolina,** and **Virginia** all provide tax credits for contributions to nonprofit school tuition organizations that operate like charities; Puerto Rico also allows a similar credit. **Kansas, New Hampshire, Pennsylvania,** and **Rhode Island** allow their credits only for corporate taxpayers; the **Florida** credit is allowed against corporate, insurance premiums, severance, alcoholic beverage taxes, and sales taxes for certain taxpayers; and **Alabama, Arizona, Georgia, Indiana, Iowa, Louisiana, Oklahoma, South Carolina,** and **Virginia** allow 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. **Louisiana** allows individuals to claim a tax deduction for qualified education expenses. **Illinois, Iowa** and **Wisconsin** provide individuals with nonrefundable tax credits for qualified education expenses, and **Alabama** allows a refundable credit for tuition expenses of students leaving state-designated low-performance schools. 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, Indiana, Iowa and New Hampshire 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

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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 due to 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 (110 percent if adjusted gross income exceeds $150,000), 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?

For calendar year taxpayers, income tax returns are due by April 15 following the close of the tax year, but there is no late filing penalty if the return is filed by 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 2015.

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 joel.michael@house.mn.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Andrew Biggerstaff **Updated: November 2014**

Minnesota Income Tax Credit for Past Military Service

What is the income tax credit for past military service?

The credit for past military service equals $750 for qualifying individuals. It is nonrefundable and is subject to an income limitation. The credit took effect in tax year 2009 and was first claimed on tax year 2009 returns filed in 2010. Eligible individuals use form M-1C to claim the credit as part of their income tax return.

Who qualifies for the credit for past military service?

To qualify for the credit, a veteran must:

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

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

What is a nonrefundable credit?

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

In tax year 2015, a single veteran with no dependents who claims the standard deduction would need to have $24,270 of federal adjusted gross income (FAGI) to receive the full $750 credit.

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

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

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

How is the military service credit income limited?

The military service credit is phased out for individuals with FAGI of $30,000 or more. The credit is reduced by 10 percent of FAGI in excess of $30,000, so that individuals with FAGI over $37,500 are not eligible for any portion of the credit.

FAGI is calculated on the federal tax forms (Form 1040, 1040A, or 1040EZ). It includes most kinds of income, such as:

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

Some of the major items excluded from FAGI are:

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

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

A qualifying veteran with less than $30,000 in taxable military retirement income and no other income other than Social Security would qualify for part or all of the credit, depending on the individual's tax liability. Since Social Security benefits are not included in FAGI for low-income filers, receipt of Social Security will not subject an individual to the income-based phaseout.

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

How many returns claim the credit and how much do they claim?

In tax year 2012, 1,631 returns claimed about $1.1 million in credits, for an average of $681.

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

HOUSE RESEARCH | Short Subjects

Nina Manzi & Danyell Punelli Updated: November 2014

Long-term Care Insurance Income Tax Credit

What is the credit?

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

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

What is the rationale for this tax credit?

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

Is the credit refundable?

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

Who is eligible for the credit?

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

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

How is the credit calculated?

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

How many Minnesotans claim the credit?

For tax year 2012, the Department of Revenue reports that 62,128 Minnesota returns claimed the credit. This is 2 percent of all state returns filed by Minnesotans.

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

How much is paid out in credits?

In tax year 2012, Minnesotans claimed $8.66 million of long-term care insurance credits. The average long-term care tax credit was $139 in tax year 2012. The average credit exceeds the maximum credit of $100 per qualified beneficiary because married couples filing joint returns may claim the maximum credit for both spouses (up to a total of $200).

How does Minnesota compare with other states?

The following table includes all states that offered a long-term care insurance tax credit in 2012, but not those states that offer a long-term care insurance tax deduction. Data on the number of claimants and cost by state is for 2012 and was provided by staff at state revenue departments and legislative offices.

In addition to the states listed, Louisiana has enacted but not funded a 10 percent credit, Maine provides a credit to employers who provide coverage to employees, Montana allows a credit for expenses of individuals who care for elderly family members, including long-term care premiums, and New Mexico allows a refundable credit of $2,800 for individuals age 65 or older with over $28,000 in medical expenses, including long-term care premiums.

	Maximum credit	Credit rate*	Number of returns claiming the credit	Cost to the state for the credit
Colorado[1]	$150	25%	18,353	$3.6 million
Maryland[2]	Varies by age: $350-$500	100%	5,019	$2.8 million
Minnesota	$100	25%	60,995	$8.5 million
Mississippi	$500	25%	3,124	$1.3 million
New York	None	20%	137,602	$79.6 million
North Carolina[3]	$350	15%	26,748	$5.7 million
North Dakota[4]	$500	100%	780	$0.3 million
Oregon	$500	15%	37,060	$8.9 million
Virginia[5]	None	15%	13,538	$3.3 million

* The credit rate is the percentage of premiums allowed as a credit.
1 Colorado's credit is income-limited; the maximum for joint filers is $150 per spouse.
2 Maryland's credit can be claimed only once per person.
3 North Carolina's credit is income-limited.
4 North Dakota's credit is limited to long-term care plans that meet consumer protection criteria and provide inflation protection.
5 Virginia's credit applies only to the first 12 months of premiums paid.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204 or Danyell Punelli at 651-296-5058.

HOUSE RESEARCH | Short Subjects

Nina Manzi and Andrew Biggerstaff

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Military Pay under Minnesota's Individual Income Tax

Military pay is exempt from Minnesota income tax

Calculation of Minnesota's individual income tax starts with federal taxable income. As a result, military pay that is exempt from taxation at the federal level, such as combat pay and hazardous duty pay, is also exempt at the state level. Minnesota allows subtraction from federal taxable income of all other types of military pay (other than retirement pay) that are taxed at the federal level, thereby making such income exempt from Minnesota income tax.

Laws 2014, chapter 308, expanded Minnesota's military pay subtraction to include pay for two categories of service previously subject to tax, effective in tax year 2014:

(1) service by a Minnesota resident serving in the National Guard while assigned to Active Guard and Reserve (AGR) status under U.S. Code, title 32

(2) service performed in accordance with Minnesota Statutes, section 190.08, subdivision 3 (i.e., current or former military personnel employed for the full-time administration of the Minnesota Department of Military Affairs)

Federal law prohibits states from taxing some types of military income

Federal law prohibits states from taxing active service military pay earned by nonresidents. Thus, a nonresident member of the military often does not need to file a Minnesota tax return.

Military pay for regular full-time active service is not taxed by the state

Minnesota also allows for the subtraction of military pay earned by a Minnesota resident for full-time active military service. This subtraction typically applies to Minnesota residents who serve either within Minnesota as full-time military recruiters or Coast Guard personnel, for example, and to Minnesota residents who are in full-time military service outside Minnesota.

Military pay for National Guard and reserve service is not taxed by the state

A member of the National Guard or other military reserve unit is allowed to subtract pay received for active service.

"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. Code, 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);

- federal active service, under U.S. Code, 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 U.S. Code, title 10; active duty orders while recuperating from an injury; and Active Guard and Reserve (AGR) service under U.S. Code, title 10 (Minn. Stat. § 190.05, subd. 5c).

Beginning in tax year 2014, "active service" also includes service by Minnesota residents working in AGR status under U.S. Code, title 32 (federally funded state active service), and service by current or former members of the National Guard or reserves ordered to active service by the adjutant general to perform full-time administration of the Department of Military Affairs.

Military pay for service outside Minnesota is not taxed by the state

Income received by Minnesota residents for military service under U.S. Code, title 10, including service in AGR status by members of the military reserves other than the National Guard, is not taxed by the state of Minnesota, and thus is not subject to Minnesota income tax withholding.

It may not be necessary for the person to file a Minnesota income tax return for a given tax year, unless a service member who has served only outside Minnesota during the year is due some specific tax-related benefit from the state (e.g., a refundable tax credit), has had other income tax withheld, or has earned a sufficient amount ($10,150 or more for tax year 2014) of other taxable military and/or nonmilitary income to require filing.

The following are some common types of income received by service members who are Minnesota residents that are normally subject to the Minnesota income tax:

- income earned by the service member's spouse living and employed within Minnesota (when filing jointly)
- nonmilitary income earned by the service member as a pay differential provided by the person's (public or private) Minnesota civilian employer
- nonmilitary income earned by the service member from civilian employment within Minnesota during part of the year (e.g., preceding or following military deployment or transfer)
- other nonmilitary income earned by the service member before, during, or following military deployment outside Minnesota (e.g., rental income from property in Minnesota)

For more information: The Department of Revenue maintains information on taxation of military pay online at http://www.revenue.state.mn.us/individuals/individ_income/Pages/Members_of_the_Military.aspx or contact legislative analyst Nina Manzi at 651-296-5204 or Andrew Biggerstaff at andrew.biggerstaff@house.mn.

HOUSE RESEARCH | Short Subjects

Steve Hinze and Andrew Biggerstaff

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Disabled Veteran Homestead Valuation Exclusion

What is the disabled veteran valuation exclusion?

This program provides a property tax benefit to qualifying homeowners by reducing the value of their home for property tax purposes by up to $300,000. The benefit applies to certain disabled veterans, their surviving spouses, the surviving spouses of military personnel who have died in the line of duty, and certain primary caregivers of disabled veterans.

What is the benefit?

Veterans who are totally and permanently disabled (100% T&P) are eligible for a valuation exclusion of $300,000; veterans who are not totally and permanently disabled, but who have a disability rating of 70 percent or higher, are eligible for an exclusion of $150,000. Surviving spouses of deceased disabled veterans that were eligible for the $300,000 exclusion are eligible to receive the same benefit for eight additional years after the veteran's death. If a disabled veteran does not own a house, but has a designated "primary family caregiver" who does own a house, the caregiver can receive the exclusion for the time he or she continues in that role. Surviving spouses of military personnel who have died in the line of duty are eligible to receive a $300,000 exclusion for eight years following the service member's death.

How does the benefit work?

The exclusion amount is subtracted from the value of the homestead as determined by the assessor before property taxes are calculated. If the value of the homestead in any year is less than the exclusion amount, the homestead is totally exempt from property taxes for that year. The actual tax benefit for a specific property will vary based on the value of the home and the local tax rate.

What are the qualifications for disabled veterans?

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

How do you enroll in the program?

Application for benefits under this program must be filed with the county assessor. A disabled veteran must provide form CR-DVHE70 or CR-DVHE100 and provide proof of honorable discharge and of disability rating. A surviving spouse of a service member who dies while in active service must provide either U.S. Government Form DD1300 or DD2064. Primary family caregivers must supply certification that they qualify under the US/VA Program of Comprehensive Assistance for Family Caregivers. Recipients must apply for the benefit each year, except that totally and permanently disabled veterans do not need to reapply each year, since their disability status is permanent and their benefit is not time-limited.

When do the benefits begin?

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

How is the tax benefit paid for?

Excluding all or a portion of the value of the disabled veteran's home from property taxes slightly increases the taxes on other properties (homes, businesses, farms, etc.) in the taxing jurisdictions where the veteran's home is located, meaning that the veteran's property tax benefit is essentially being provided by the other properties within the same taxing jurisdictions.

What about special assessments?

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

Are there survivor benefits?

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

How does the exclusion apply to an agricultural homestead?

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

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

Properties that qualify for the disabled veterans homestead valuation exclusion do not receive the "regular" market value homestead exclusion of $30,400 or less. Properties that qualify for the disabled veterans homestead valuation exclusion are not eligible to receive the preferential classification (1b) generally available on the first $50,000 of market value on homesteads owned by persons who are blind or disabled. Disabled veterans, surviving spouses, and primary caregivers continue to be eligible for the property tax refund program, although it is likely that they would qualify for a significantly smaller refund because their property taxes would be so much lower due to the exclusion.

For more information: Contact legislative analyst Steve Hinze at steve.hinze@house.mn or Andrew Biggerstaff at andrew.biggerstaff@house.mn. Also see the Department of Revenue's fact sheet on the disabled veterans exclusion program at http://www.revenue.state.mn.us/propertytax/factsheets/factsheet_13.pdf .

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Steve Hinze **Updated: December 2014**

Targeting Property Tax Refund

What is targeting?

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

Who qualifies?

A homeowner qualifies if the property tax on the home has increased by more than 12 percent over the previous year's tax and if the increase is over $100. In determining eligibility, the previous year's tax amount is the net amount paid by the homeowner after deduction of any targeting refund received in that year.

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

How does targeting work?

Generally, the refund equals 60 percent of the increase over the greater of (1) 12 percent of the previous year's tax after deduction of targeting, or (2) $100. The maximum refund is $1,000. The targeting refund is calculated prior to calculation of the homestead credit refund. The following example shows how the refund is calculated.

Payable 2014 Property Tax after Targeting Payable 2015 Property Tax	$1,600 $2,000
2015 tax increase (over 2014) Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x $1,600)	$400 $192
Remaining increase eligible for relief ($400 - $192 = $208)	$208
State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $208 = $125)	$125
Amount of 2015 increase paid by taxpayer ($400 - $125)	$275

The taxpayer's $400 increase (i.e., 25 percent) is reduced to an out-of-pocket property tax increase of $275 (i.e., 17.2 percent) as a result of the $125 refund.

The taxpayer pays the full $2,000 amount of the 2015 property tax to the county, the first half in May and the second half in October. The taxpayer applies to the state for a targeting refund on form M1PR. The targeting refund is paid at the same time the regular homestead credit refund ("circuit breaker") is paid in late September.

Does targeting have any other restrictions?

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

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

What are statewide amounts?

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

The $729,000 in targeting refund claims filed in 2013 is the first time refunds have totaled less than $1 million. The changes from one year to the next generally track changes in property taxes on homesteads. For example, from 2011 to 2012, homestead property taxes increased on average in Greater Minnesota and remained relatively constant in the metro area.

Targeting Refunds, Filed 2010 – 2013 (dollars in thousands)

	Filed 2010	Filed 2011	Filed 2012	Filed 2013
Total Metro	$1,024	$1,211	$570	$380
Total Nonmetro	$1,310	$691	$2,696	$348
State	$2,334	$1,902	$3,266	$729

Some taxpayers (e.g., those who typically don't qualify for the homestead credit refund) may not be aware of the targeting program, resulting in lower total refunds statewide than if all eligible taxpayers had filed.

How many homeowners claim the refund?

In 2013, just over 6,000 homeowners claimed refunds based on their property tax increase from payable 2012 to 2013. The average refund amount was $118.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR, the homestead credit refund form. There is a separate schedule on the back of the M1PR ("Schedule 1 – Special Refund") for the targeting program. The taxpayer files for this refund after receiving his or her property tax statement in February or March. Claims filed before August 15, 2015, will be paid beginning in late September 2015. The deadline for filing claims based on taxes payable in 2015 is August 15, 2016; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's website, under "Forms and Instructions" (www.revenue.state.mn.us).

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.revenue.state.mn.us. Also see the House Research Short Subject *Homestead Credit Refund Program*, December 2014, and the Information Brief *Targeting*, December 2014.

Joel Michael and Nina Manzi Updated: December 2014

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 $12,160 and $22,970 for care provided in 2013, 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.

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

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.

Nearly $82 million was recaptured in 2013

The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2009 to 2013.

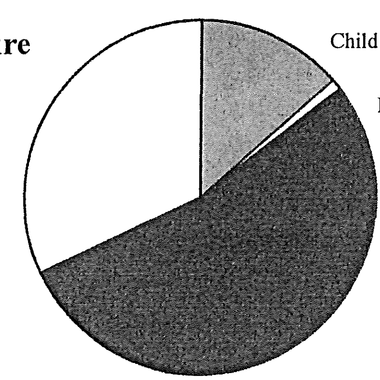
The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2009 to 2013 by four of the major types of debts for which the law sets priorities.

Revenue Recapture Amounts CY2009-2013

	Number of Offsets	Amount of Recapture
2009	216,623	$72,845,049
2010	226,754	$78,173,924
2011	193,629	$63,231,794
2012	231,085	$78,408,559
2013	228,262	$81,743,032

2011 to 2013 data exclude offsets for unpaid state taxes. In 2013, there were 121,886 offsets for $33,268,282 in unpaid state taxes.
All years exclude amounts offset to satisfy federal debts.
Source: DOR

Revenue Recapture Amounts CY2009-2013



For more information: See www.revenue.state.mn.us/collections/Pages/Revenue_Recapture.aspx for more information, or contact the Department of Revenue at 651-556-3037; or email at revenue.recapture@state.mn.us.

Nina Manzi & Joel Michael Updated: December 2014

Minnesota Individual Alternative Minimum Tax

What is the alternative minimum tax?

The federal and state alternative minimum taxes (AMT) 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 current structure of the two taxes (as alternative, rather than add-on, 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 require taxpayers to compute a tentative liability under a second tax structure. This second tax structure, the AMT, has a broader tax base (due to fewer deductions, exemptions, and credits) and lower rates than the regular tax. If the tentative tax is higher than the taxpayer's regular tax liability, the taxpayer pays the difference. In effect, the AMT takes away part of the benefit of tax preferences that lowered the regular tax.

Who pays the AMT?

AMT filers fall into three main groups:

- Those who have large amounts of deductions that are allowed under the regular tax but not under the AMT
- Taxpayers with large families whose personal exemptions and standard deduction (or typical itemized deductions) under the regular tax exceed the flat exemption amount allowed under the AMT
- Taxpayers with income above the level at which the AMT exemption is fully phased out

How are the federal and state AMTs different?

The federal and state AMTs have two major differences.

- The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not.
- The Minnesota AMT has one flat rate, while the federal tax has two rates.

How are the Minnesota regular tax and AMT different?

The Minnesota AMT uses a broader tax base than the regular tax does and applies a single 6.75 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 2015 tax year)

Feature	Regular Tax	AMT
Tax base	Federal adjusted gross income	Federal adjusted gross income
Rules carried over from federal AMT that add to tax base		Less generous depreciation rules Incentive stock options Depletion Intangible drilling costs Tax-exempt interest from private activity bonds
Standard deduction	$12,600 (married joint) $6,300 (single) $9,250 (head of household)	$73,360 for married joint (phased out for income from $150,000 to $443,440) $55,020 for single and head of household (phased out for income from $112,500 to $332,580)
Personal exemptions	$4,000 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%; 9.85%	6.75% (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 $29.4 million in tax year 2015, from about 8,000 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.

HOUSE RESEARCH | **Short Subjects**

Colbey Sullivan and Nina Manzi

Updated: December 2014

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of Minnesota Management and Budget (MMB) 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 2014 forecast provided the revenue and expenditure projections that the governor will use in developing the budget proposal for the fiscal year 2016-2017 biennium, which runs from July 1, 2015, to June 30, 2017. The November 2014 forecast also showed that the state is on track to finish the fiscal year 2014-2015 biennium with a positive balance.

The February forecast modifies the preceding November's forecast with any new data that's available. The February 2015 forecast will provide the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2016-2017 biennium. Following the February forecast, the governor will submit modifications to the budget proposal developed from the November forecast, which are called "supplemental budget recommendations." The February 2015 forecast will also provide 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 2015 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2016-2017 budget during the 2016 legislative session. The legislature will use the projections in the February 2016 forecast to ensure that the fiscal year 2016-2017 biennium closes with a balanced budget.

What if a forecast shows a budget shortfall?

If a forecast projects a shortfall for the *general fund in the current biennium*, the commissioner of MMB 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 MMB must reduce allotments from that fund to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations to the legislature 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 MMB must allocate the surplus in priority order as follows:

1. to the cash flow account, until it reaches $350 million (currently satisfied)
2. to the budget reserve account, until it reaches $810.992 million (currently surpassed)
3. to increase the school aid payment schedule to 90 percent, in increments of one-tenth of 1 percent with any residual amount deposited in the budget reserve (currently satisfied)
4. to restore previous school aid reductions and reduce the property tax recognition shift accordingly (currently satisfied)

If a November forecast projects a surplus and priorities (1) to (4) have been satisfied, 33 percent of the surplus is transferred to the budget reserve, until the reserve reaches the percentage of the current biennium's revenues recommended as a reserve. The commissioner must update the percentage each January based on a review of the adequacy of the reserve and the volatility of Minnesota's tax structure. Under this requirement, the commissioner transferred $183 million to the budget reserve after the November 2014 forecast, bringing the amount in the reserve to $994 million.

Any surplus remaining after meeting the four priorities and making the 33 percent transfer is reported in the forecast as a "positive unrestricted budgetary general fund balance." For the fiscal year 2014-2015 biennium, this balance is $373 million.

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

What are recent changes to treatment of budget surpluses?

Laws 2014, chapter 150, requires the commissioner to recommend a budget reserve level specified as a percentage of current biennium revenues, to update the percentage each January, and to transfer 33 percent of a November forecast surplus to the reserve.

Laws 2014, chapter 150, also removed restoration of $15 million transferred in 2008 from the state airports fund to the general fund from the list of priorities, since this item was satisfied following the November 2013 forecast.

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

HOUSE RESEARCH | Short Subjects

Danyell Punelli

Updated: December 2014

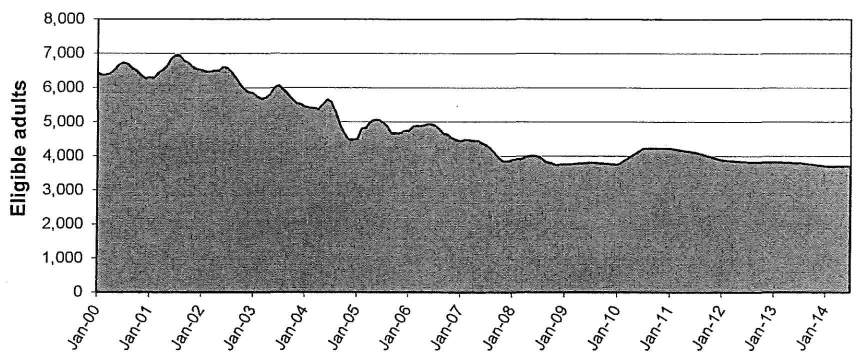
Noncitizens on MFIP

This short subject provides information about noncitizens' use of the Minnesota Family Investment Program (MFIP). To learn about which noncitizens are eligible for MFIP, see the House Research publication *Eligibility of Noncitizens for Health Care and Cash Assistance Programs*.

The number of MFIP-eligible adults who are noncitizens

In July 2014, there were 3,704 MFIP-eligible adults who were not U.S. citizens. This is down from a peak of about 6,900 adults in the summer of 2001. Prior to the introduction of the Diversionary Work Program (DWP) in July 2004, there was seasonal variation in the number of MFIP-eligible adults, with caseloads peaking each summer due to migrant farm workers. Since July 2004, these families have been enrolled in DWP, a short-term employment program that offers intensive services to divert people from MFIP.

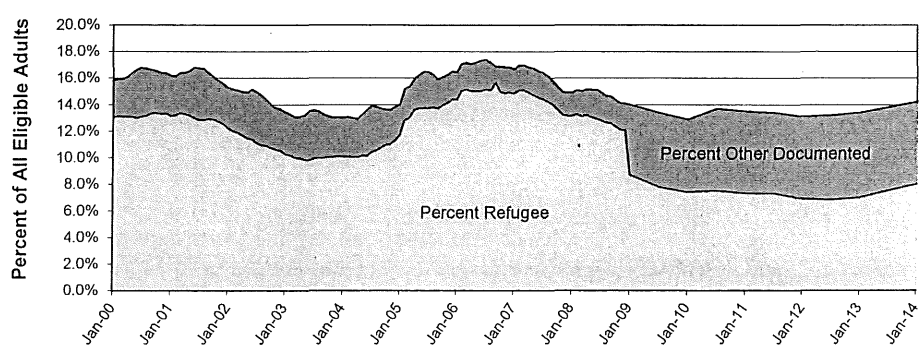
Figure 1. Number of MFIP-eligible Adults that were Noncitizens, 2000 to 2014



The percent of MFIP-eligible adults who are noncitizens

The percent of MFIP cases with noncitizens fell from 16.8 percent in July 2000 to 12.9 percent in April 2004, and rose to 17.4 percent in July 2006 before falling to 13.1 percent in January 2012. The percentage of noncitizens decreased in 2002 and 2003 as the number of new refugee arrivals decreased due to changes in immigration policy. In 2005, Minnesota received a large, onetime settlement of Hmong refugees. By July 2008, the number of Hmong caregivers on MFIP had returned to July 2004 levels. Even though MFIP cases fell to historic lows in 2007 and 2014, the percentage of the total caseload made up of eligible noncitizens during those years increased because the overall caseload was decreasing faster than the noncitizen caseload.

Figure 2. Percent of MFIP-eligible Adults that were Noncitizens, 2000 to 2014



Geography of noncitizens on MFIP

In July 2014, Hennepin and Ramsey counties had the most MFIP cases with at least one eligible adult that was a noncitizen (36 percent of noncitizen MFIP cases lived in Hennepin County and 28 percent lived in Ramsey County). Within those counties, 15 percent of all Hennepin County MFIP cases had an eligible noncitizen caregiver and 18 percent of all Ramsey County cases had an eligible noncitizen caregiver. Less than 1 percent of the cases with eligible noncitizens were in the northwest or northeast regions.

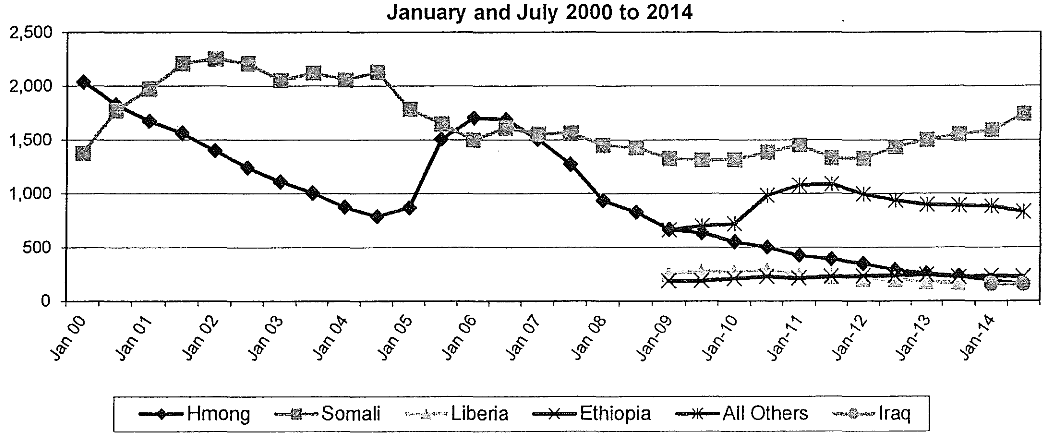
Region of MFIP Cases with at Least One Eligible Noncitizen Caregiver, July 2014

Region	Number of Cases	Percent of Cases in Region	Percent of Noncitizen Cases
Northwest	10	4.6	0.4
West Central	71	3.5	2.5
Northeast	7	0.5	0.3
Central	351	21.8	12.2
Southwest	61	15.8	2.1
South Central	91	15.2	3.2
Southeast	199	14.3	6.9
Metro Suburbs	254	9.7	8.8
Hennepin County	1,020	15.3	35.5
Ramsey County	807	17.6	28.1
Total Noncitizens	2,871		100.0

Nationality of MFIP-eligible noncitizens

Although more than 30 nationalities are represented in MFIP families at any time, the largest in recent years has been Somali. The number of Hmong caregivers decreased throughout the early 2000s until 2005, when Minnesota received a large, onetime resettlement of Hmong families. By July 2008 the number of Hmong caregivers had returned to the July 2004 level, and has continued to decrease.

Figure 3. Top Nationalities of MFIP-eligible Noncitizens, January and July 2000 to 2014



About the data

All data are from the Department of Human Services MAXIS data warehouse. MFIP-eligible adults that were recorded in MAXIS as noncitizens for the eligibility month are reported. Immigration status was the status of the person in the eligibility month, except for those who entered the United States as refugees or asylees and became legal permanent residents. Those people were counted as refugees, regardless of their current status. Case-level data were reported for geographic location so as not to double count cases with two eligible adults.

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

Nina Manzi & Steve Hinze

Updated: December 2014

Homestead Credit Refund Program

What is the homestead credit refund program?

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

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

The program uses household income, a broad measure that includes most types of income, including income that is not subject to income tax. Deductions are allowed for dependents and for claimants who are over age 65 or disabled. The refund is based on taxes payable after subtracting any targeting refund claimed by the homeowner.

What aspects of the program have changed recently?

The 2011 and 2013 tax laws both expanded the refund program. The 2011 changes increased the maximum refund for homeowners with incomes under about $37,000, and decreased the copayment percentage for most homeowners. The 2013 changes, effective for refunds based on taxes payable in 2014, lowered the threshold percentage for determining eligibility from 3.5 percent of income to 2.0 percent of income for homeowners with household incomes from $19,530 to $65,049, and to 2.5 percent for those at higher income levels.

What are the maximums?

For refund claims filed in 2015, based on property taxes payable in 2015 and 2014 household income, the maximum refund is $2,620. Homeowners whose income exceeds $107,149 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR, which is filed separately from the individual income tax form. Claims based on taxes payable in 2015 that are filed before August 15, 2015, will be paid beginning in late September 2015; claims filed electronically may be paid a month earlier. The deadline for filing claims based on taxes payable in 2015 is August 15, 2016; taxpayers filing claims after that date will not receive a refund.

How many homeowners receive refunds, and what is the total amount paid?

Based on payable 2013 property taxes and 2012 incomes, 339,197 homeowners received refunds. The average refund was $797, and the total dollar amount of refunds paid statewide was $270.4 million. The average refund for senior and disabled claimants ($811) was slightly higher than the average for those under age 65 and not disabled ($787).

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

The following table shows the refund calculations for four example families with different incomes—two families in the metro area and two in Greater Minnesota. Although the program parameters are the same statewide, the average residential homestead property tax in the metro area is higher than in Greater Minnesota. The example metro area families have homes valued at $245,000 and payable 2015 property taxes of $3,315, typical amounts for the metro area. The example families in Greater Minnesota have homes valued at $147,600 and payable 2015 property taxes of $1,430, typical amounts for Greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple, both under age 65, two dependents
Example refunds for claims to be filed in 2014,
based on taxes payable in 2014 and 2013 income

		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Property tax	$3,315	$3,315	$1,430	$1,430
2	Gross income	$35,000	$75,000	$35,000	$75,000
3	Deduction for dependents	$10,665	$10,665	$10,665	$10,665
4	Household income (2 – 3 = 4)	$24,335	$64,335	$24,335	$64,335
5	Threshold income percentage	2.0%	2.0%	2.0%	2.0%
6	Threshold % x income (4 x 5 = 6)	$487	$1,287	$487	$1,287
7	Property tax over threshold (1 – 6 = 7)	$2,828	$2,028	$943	$143
8	Statutory copay percentage	30%	40%	30%	40%
9	Taxpayer copay amount (7 x 8 = 9)	$848	$811	$283	$57
10	Remaining tax over threshold (7 – 9 = 10)	$1,980	$1,217	$660	$86
11	Maximum refund allowed	$2,620	$1,860	$2,620	$1,860
12	Net property tax refund	$1,980	$1,217	$660	$86
13	Net property tax paid after refund (1 – 12)	$1,335	$2,098	$770	$1,344

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.revenue.state.mn.us.

Nina Manzi and Steve Hinze

Updated: December 2014

Renter's Property Tax Refund Program

What is the renter's property tax refund program?

The renter's property tax refund program (sometimes called the "renters' credit") is a state-paid refund that provides tax relief to renters whose rent and "implicit property taxes" are high relative to their incomes. "Rent constituting property taxes" is assumed to equal 17 percent of rent paid. If rent constituting property taxes exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

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

The program uses household income, a broad measure that includes most types of income, including income that is not subject to income tax. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

What are recent changes to the program?

The 2013 tax law expanded the program, by lowering the threshold percentage for determining eligibility from 3.5 percent of income to 2.0 percent of income, in conjunction with reductions to the homeowner thresholds. It also increased the maximum refund to $2,000 for refunds based on rent paid in 2013.

For refunds based on rent paid from 1998 to 2008, the percentage of rent constituting property taxes was 19 percent. It was reduced to 15 percent for refunds based on rent paid in 2009 only under Gov. Tim Pawlenty's June 2009 unallotment, subsequently enacted into law. For refunds based on rent paid in 2010, the percentage returned to 19 percent. The 2011 tax law reduced the rate to 17 percent for refunds based on rent paid in 2011 and following years.

What are the maximums?

For refund claims filed in 2015, based on rent paid in 2014 and 2014 household income, the maximum refund is $2,030. Renters whose income exceeds $58,059 are not eligible for refunds.

How are claims filed?

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Schedule M1PR is filed separately from the individual income tax form. Claims filed before August 15, 2015, will be paid beginning in August 2015. The deadline for filing claims based on rent paid in 2014 is August 15, 2016; taxpayers filing claims after that date will not receive a refund.

How many renters receive refunds, and what is the total amount paid?

Based on rent paid in 2012 and 2012 incomes, 304,016 renters received refunds. The average refund was $594, and the total dollar amount of refunds paid statewide was $180.5 million. The average refund for senior and disabled claimants ($637) was slightly higher than the average for those under age 65 and not disabled ($576).

How do refunds vary depending on income and property taxes?

The following table shows the refund amount for four example families (married couples without dependents). Although the threshold percentage, copayment rates, and maximum refund amounts are the same statewide, the average rent is higher in the metro area than in Greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple, both under age 65, no dependents
Example refunds for claims to be filed in 2015,
based on rent paid in 2014 and 2014 household income

		Metro area		Greater Minnesota	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #1**	**Taxpayer #2**
1	Monthly rent, one bedroom apartment	$796	$796	$542	$542
2	Annual rent (1 x 12 = 2)	$9,552	$9,552	$6,504	$6,504
3	Rent constituting property tax (2 x 17% = 3)	$1,624	$1,624	$1,106	$1,106
4	Gross income	$15,000	$30,000	$15,000	$30,000
5	Deduction for dependents	0	0	0	0
6	Household income (4 – 5 = 6)	$15,000	$30,000	$15,000	$30,000
7	Statutory threshold percentage	1.4%	2.0%	1.4%	2.0%
8	Threshold % x income (7 x 6 = 8)	$210	$600	$210	$600
9	Property tax over threshold (3 – 8 = 9)	$1,414	$1,024	$896	$506
10	Copay percentage	15%	30%	15%	30%
11	Taxpayer copay amount (9 x 10 = 11)	$212	$307	$134	$152
12	Remaining tax over threshold (9 – 11 = 12)	$1,202	$717	$761	$354
13	Maximum refund allowed	$1,830	$1,680	$1,830	$1,680
14	Net property tax refund	$1,202	$717	$761	$354

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.revenue.state.mn.us.

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: December 2014

Alcoholic Beverage Taxes

Two special state taxes apply to alcoholic beverages: excise taxes and a gross receipts tax

Minnesota imposes two types of special taxes on alcoholic beverages:

- **Special excise taxes** are imposed on manufacturers or wholesalers of these products. These taxes are a fixed dollar amount per unit (per barrel or liter). The tax rates vary by beverage type. See the table below for tax rates.
- A **special gross receipts tax** of 2.5 percent applies to retailers making both on-sale (to be consumed in bars or restaurants) and off-sale (in liquor stores or by other sellers) sales. The tax is imposed on the retail price (receipts).

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

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

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

Because the excise taxes are fixed dollar amounts, they don't vary by the price of the product. Higher priced products pay the same tax as lower priced products. Moreover, revenues grow only as more liters or barrels of the products are sold; revenues don't increase with inflation (price increases). For revenues to keep pace with inflation, the legislature must adjust the tax rates periodically. It has done this only sporadically (most recently in 1987). In inflation-adjusted terms, the excise tax rates in 2014 are less than half the amounts that they were in 1987.

Few exemptions apply

The law exempts the following from the excise tax:

- Sacramental wine
- Products sold to food processors and pharmaceutical companies
- The first 25,000 barrels of beer produced by a brewery with annual production of less than 250,000 barrels (A barrel is 31 gallons.)

Revenues go to the general fund

Revenues from both the excise taxes and the gross receipts tax go to the general fund. Fiscal year 2014 revenues from the excise taxes were about $85 million and from the gross receipts tax, $80 million. Thus, the gross receipts tax raises about 49 percent of alcohol tax revenues. The table to the right shows the collections by beverage type for the excise tax and for the additional gross receipts tax. The excise tax revenue from liquor reflects the higher rates imposed on these products, rather than their share of the market (measured by dollars spent). The sales tax imposes a much higher tax burden on wine and beer than the excise tax does.

Beverage Type	FY2014 Revenues (000)	% of Total
Beer < 3.2%	$234	0.14%
Beer > 3.2%	14,892	9.03%
Cider	258	0.16%
Wine < 14%	4,562	2.77%
Wine > 14%	595	0.36%
Sparkling Wine	1,127	0.68%
Distilled Spirits	62,992	38.19%
Excise tax total	84,661	51.32%
2.5% gross receipts tax	80,305	48.68%
Total	**$164,966**	
Source: MN Department of Revenue		

Minnesota tax compared with other states

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

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

Tax relative to alcohol content varies

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

Tax is regressive

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

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

HOUSE RESEARCH | **Short Subjects**

Nina Manzi **Updated: December 2014**

The Minnesota and Federal Dependent Care Tax Credits: An Overview

What are the credits?

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

Are the credits refundable?

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

Who is eligible for the credits?

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

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

What are qualifying expenses?

Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include amounts paid to the claimant's spouse or another dependent.

Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse). Maximum allowable qualifying expenses are reduced by amounts paid through dependent care pre-tax accounts.

How are the credits calculated?

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

The *state credit* equals the lesser of the federal credit, or $720 for one child ($1,440 for two or more children). The state credit is calculated by reference to the federal credit for which the claimant is eligible, not the amount the claimant could have used to offset federal liability.

The state credit is subject to an income phaseout. (By contrast, the federal credit rate phases down to a minimum percentage but is never totally phased out.) In tax year 2015, the state phaseout begins when income exceeds $25,750, and the state credit is fully phased out when income exceeds $39,400. The income threshold for the phaseout is adjusted each year for inflation.

How do filers claim the credits?

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

How many Minnesotans claim the credits?

In tax year 2012, 148,780 Minnesotans claimed the federal dependent care credit and 35,742 claimed the state credit. These claims represent 5.7 percent of all federal returns filed by Minnesotans and 1.3 percent of all state returns filed.

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

Because the state credit is refundable and subject to an income-based phaseout (from $24,300 to $37,950 in tax year 2012, the year of the data), most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2012, Minnesotans claimed $70.0 million of federal dependent care credits. The average federal dependent care credit was $471.

In tax year 2012, Minnesotans claimed $14.6 million of state dependent care credits. The average state dependent care credit was $407.

How does Minnesota compare with other states?

Nationwide, 4.3 percent of all income tax returns claimed the federal dependent care credit, compared to 5.7 percent in Minnesota. Nebraska had the highest percentage of returns claiming the federal credit at 6.3 percent, and West Virginia had the lowest at 2.3 percent.

The average federal dependent care credit in 2012 was $539 nationwide and $471 in Minnesota. New York had the highest average credit at $595, and Wisconsin had the lowest at $459. Minnesota's average credit amount may be lower than the national averages because state residents have above-average incomes, or because Minnesotans are more likely to receive child care assistance or use pre-tax dependent care accounts, reducing the amount of qualifying expenses.

How is Minnesota affected by the ATRA changes to the federal credit?

In the 2014 session, Minnesota enacted legislation to conform the state credit calculation phaseout to the larger federal credit allowed under the American Taxpayers Relief Act of 2012 (ATRA), beginning in tax year 2014. For tax year 2013, Minnesota claimants were required to determine their state credit by reference to the smaller federal credit that would have been in effect had ATRA not been enacted. Beginning in tax year 2014, Minnesota claimants will determine their state credit by reference to the current federal credit.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, February 2014.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2014

The Federal Earned Income Tax Credit and Minnesota Working Family Credit: An Overview

What are the credits?

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

Who is eligible for the credits?

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2015, individuals with more than $3,400 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

How are the credits calculated?

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2015, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

	Maximum credit		**Phaseout threshold**		**Income at which credit fully phased out**	
	EITC	WFC	EITC	WFC	EITC	WFC
Unmarried claimants						
No children	$503	$132	$8,240	$8,260	$14,820	$14,821
1 child	$3,359	$1,057	$18,110	$21,520	$39,131	$39,071
2 children	$5,548	$2,038	$18,110	$25,530	$44,454	$44,368
3 or more children	$6,242	$2,038	$18,110	$25,530	$47,747	$44,368
Married claimants						
No children	$503	$132	$13,760	$13,780	$20,340	$20,341
1 child	$3,359	$1,057	$23,630	$27,040	$44,651	$44,591
2 children	$5,548	$2,038	$23,630	$31,050	$49,974	$49,888
3 or more children	$6,242	$2,038	$23,630	$31,050	$53,267	$49,888

How do filers claim the credits?

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

How many Minnesotans claim the credits?

In tax year 2012, 354,700 Minnesota returns claimed the EITC and 324,686 claimed the WFC. These claims represent 13.5 percent of all federal returns filed by Minnesotans and 12.0 percent of all state returns filed by Minnesota residents. The number of EITC claims exceeds the number of WFC claims mostly because in 2012, the higher EITC rate for families with three or more children resulted in the EITC for large families extending to higher incomes than did the WFC, which did not have a higher rate for families with three or more children.

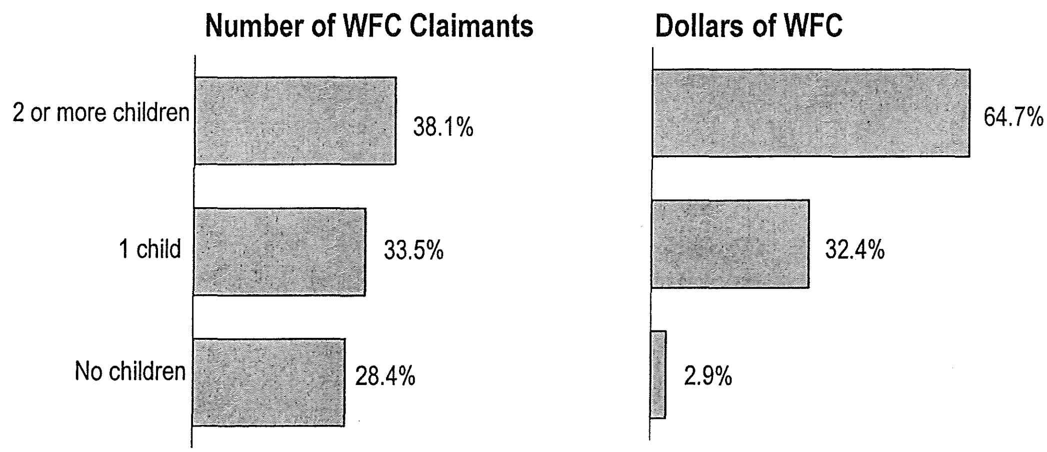
How much is paid out in credits?

In tax year 2012, Minnesotans claimed $718 million in EITC, of which $82 million offset tax liability, and the remaining $636 million was paid as a refund. The average EITC claimed by Minnesotans was $2,025.

Minnesota returns claimed an additional $196 million in WFC, of which $35 million offset tax liability, and the remaining $161 million was paid as a refund. The average WFC was $605.

How are the credits distributed among different types of families?

Seventy-two percent of all working family credits went to families with one or more children. These families received about 97 percent of the total amount of credits paid in 2012. Individuals without children filed 28.4 percent of returns claiming credits, but received only 2.9 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children. The distribution of earned income tax credits is similar.



How are the credits distributed geographically?

In 2012 about half of the returns claiming credits were in the Twin Cities metropolitan area and half in Greater Minnesota; 18 percent of returns in Beltrami and Wadena counties claimed credits, compared with only 7 percent in Carver County. The highest average credit went to Watonwan County claimants, at $686, and the lowest to Blue Earth County claimants, at $529.

How does Minnesota compare with other states?

Nationwide, 19.2 percent of all income tax returns claimed the EITC, compared to 13.5 percent in Minnesota. The average EITC nationwide in 2012 was $2,311; it was $2,025 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

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

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, March 2013.

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

Jamie Olson

December 2014

Regulation of Electronic Cigarettes

The Minnesota Clean Indoor Act (MCIAA) prohibits smoking in nearly all indoor areas. The 2014 Legislature expanded portions of MCIAA by implementing regulations on electronic cigarettes (Laws 2014, ch. 291). These provisions took effect on July 1, 2014.

What is an electronic cigarette?

Under Minnesota Statutes, section 609.685, subdivision 1, paragraph (c), an "electronic delivery device" (referred to as an electronic cigarette) is defined as any product containing or delivering nicotine, lobelia, or other substance intended for human consumption that is used to simulate smoking through inhalation of vapor. This includes all of the components of the product, even if they are sold separately, but does not include products approved by the Food and Drug Administration as tobacco-cessation products, tobacco-dependence products, or other medical purposes, which are marketed and sold for that purpose.

The definition of "tobacco-related products" was also expanded to include devices intended to be used in ingest the vapor of tobacco or tobacco products.

Where is use of electronic cigarettes prohibited?

The MCIAA (Minn. Stat. §§ 144.411 to 144.417), in conjunction with the Freedom to Breathe Act of 2007, prohibited smoking of tobacco products in public places and places of employment. Use of electronic cigarettes is prohibited only in the following locations:

- Day care centers
- Health care facilities
- Any building owned or operated by the state, home rule charter or statutory city, county, township, school district, or other political subdivision
- Buildings owned by Minnesota State Colleges and Universities and the University of Minnesota
- Facilities licensed by the Department of Human Services
- Facilities licensed by the Department of Health, but only if that facility is also subject to federal licensing requirements
- Public schools

Can local jurisdictions or businesses adopt more restrictive ordinances?

Minnesota Statutes, section 144.414, subdivision 5, paragraph (b), specifically allows political subdivisions and businesses to adopt more restrictive prohibitions on the use of electronic cigarettes.

Are electronic cigarettes licensed the same as tobacco products?

Under Minnesota Statutes, section 461.12, the sale of electronic cigarettes is subject to the same municipal licensing provisions as other tobacco products. The law also extends a municipality's ability to conduct compliance checks to places where electronic cigarettes are sold. Electronic cigarettes are prohibited both from being accessible to the public without the intervention of a store employee and from being sold in vending machines in the same way as tobacco products.

What are the packaging requirements for electronic cigarettes?

Starting January 1, 2015, liquids sold as part of the use of an electronic cigarette, regardless of whether it contains nicotine, must be packaged in child-resistant packaging. Child-resistant packaging is defined under the Code of Federal Regulations, title 16, section 1700.20, effective on January 1, 2015.

How are sales of electronic cigarettes regulated?

Under Minnesota Statutes, section 461.21, electronic cigarettes are prohibited from being sold from a kiosk, which is defined as a moveable place of business where the physical location is not permanent. The prohibition on kiosk sales is effective January 1, 2015, for contracts in effect as of May 1, 2014, and is effective August 1, 2014, for a contract entered into after May 1, 2014.

The penalties for sale of electronic cigarettes to persons under the age of 18 and use of electronic cigarettes by persons under the age of 18 are the same as for sales and use of tobacco products, and the same exceptions apply under Minnesota Statutes, section 609.685.

For more information: Contact legislative analyst Jamie Olson at 651-296-5043. Also see the House Research publications *Freedom to Breathe Act of 2007*, June 2013, and *Minnesota Clean Indoor Air Act*, July 2007.

HOUSE RESEARCH | Short Subjects

Deborah Dyson and Mark Shepard
Updated: December 2014

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 no more than $165,003 for 2015, unless a waiver of the limit applies to the position. See Minnesota Statutes, section 43A.17, subdivision 9, and the Minnesota Management and Budget (MMB) website at http://mn.gov/mmb/employee-relations/compensation/laws/local_gov/comp-limits/.

The compensation limit for local government employees 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, 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. 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 Management and Budget 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 Consumer Price Index (CPI) from the prior year. Minn. Stat. § 43A.17, subds. 3 and 9. According to MMB, as of January 1, 2015, a local government may increase by 1.7 percent the compensation of an employee with an existing waiver for compensation that exceeds the current limit. If the existing approved waiver amount is below the current limit, the local government may increase an employee's compensation to the 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 to 110 percent of the governor's 2005 salary, with an annual adjustment for inflation using the CPI for all urban consumers in the prior year. The reference to 110 percent of the governor's salary is still in law, but is not currently relevant because the inflationary increases prescribed by law have made the current limit of $165,003, much higher than 110 percent of the governor's salary. (In 2015, 110 percent of the governor's salary is $136,303.)

The local government limits do not apply to state employees

The statute limiting political subdivision salaries does not cover state employees. State law assigns executive branch agency heads to two salary ranges, which are capped at 133 percent and 120 percent of the governor's salary. Minn. Stat. § 15A.0815, subds. 2 and 3. (These limits are adjusted annually for inflation.) Until 2013, the salary of employees of executive branch agencies was limited to the salary of the agency head, but this limit was repealed in 2013. Salaries for these employees are set by collective bargaining agreements or compensation plans that are approved by the legislature.

For more information: Contact legislative analysts Deborah Dyson at deborah.dyson@house.mn or Mark Shepard at mark.shepard@house.mn. Also see the House Research publications *State Agency Head Salaries*, July 2014, and *State Elected Officials' Compensation*, July 2014.

Pat Dalton

Updated: December 2014

The City LGA Program

The current formula was enacted in 2013

The city local government aid (LGA) program has existed since 1972; however, the formula for aid distribution has changed over time. The current formula for the program was enacted in 2013. The new formula addresses a number of criticisms of the previous formula, such as complexity, volatility, and amount of aid distributed "off-formula." The formula calculates increases and decreases in each city's aid based on the gap between its "unmet need" and its current aid level. Cities with large gaps will get larger aid increases, and cities whose aid is more than their current "unmet need" will gradually lose aid over time.

Virtually all of the LGA appropriation is distributed via the formula

The city LGA appropriation is $507.6 million for aids payable in 2014, $516.9 million for aids payable in 2015, and $519.4 million for aids payable in 2016 and thereafter. In 2014 all but $1.31 million is distributed via the formula. Beginning with aids payable in 2015, only $310,000 is distributed as nonformula aid. Prior to the change, $24 million was distributed to various cities outside of the formula.

There are three need formulas for cities—based on a city's size

The measure of a city's "need" depends on its population:

- **For small cities (population less than 2,500):** need per capita is based solely on the city's population
- **For medium-size cities (population between 2,500 and 10,000):** need per capita is based on (1) percent of housing built before 1940, (2) household size, and (3) population decline from a city's peak population in the last 40 years
- **For large cities (population over 10,000):** need per capita is determined by (1) jobs per capita, (2) age of housing stock (both housing built before 1940 and housing built between 1940 and 1970), and (3) a sparsity adjustment for cities with a population less than 150 per square mile

A city's aid changes based on differences between its unmet need and its previous aid

Each city's unmet need is equal to the difference between (1) its need per capita multiplied by its population, and (2) its equalized net tax capacity multiplied by the average tax rate for all cities in the previous year. If the city's "unmet need" is greater than the amount of aid it received in the previous year, its aid will increase. The increase equals a percentage of the gap between the city's unmet need and its previous aid amount. The percentage is the same for all cities. For aid payable in 2014, this percentage is 19.5.

If a city's aid in the previous year is greater than its unmet need, its aid will decrease; either to the unmet need amount or by the maximum allowed annual decrease (see next page).

Annual aid fluctuations will be minimized

A city whose current aid is far below its "unmet need" measure will see larger dollar increases than a city whose aid is close to its "unmet need." Over time all cities will gradually move toward receiving aid equal to their unmet need amount. Because aid is based on each city's need rather than on changes in need for all cities, payments to individual cities will be more stable.

Characteristics of the Current LGA Program

Funding level	$516.9 million in Payable 2015, $519.4 million thereafter
Nonformula aid	• Warroad - $150,000/year for five years • Red Wing - $1,000,000 for 2014 only • Mahnomen - $160,000/year permanently
"Formula need"[1]	For cities with a population of less than 2,500: Need per capita = $410 + .0367 x (city population – 100) up to a maximum of $630 For cities with a population of at least 2,500 but less than 10,000: Need per capita = 1.15 x {$572.62 + (5.026 x percent of housing built before 1940) – (53.768 x average household size) + (14.022 x population decline from the city's peak census population)} For cities with a population of 10,000 or more: Need per capita = 1.15 x {307.664 + (4.59 x percent of housing built before 1940) (0.622 x percent of housing built between 1940 and 1970) + + (169.415 x jobs per capita in city) + (100 if the city population density is less than 150 person/sq. mile)}
"Unmet need"	= ("Formula need" x population) – (city net tax capacity x average city tax rate)
Formula aid	For cities whose unmet need is *less* than its previous year aid: Formula aid = "Unmet Need" For cities whose unmet need is *greater* than its previous year aid: Formula aid = last year's formula aid + X% of the difference between its "unmet need" and its aid in the previous year
Final aid	= Formula aid + nonformula aid; subject to the maximum annual decrease
Limits on annual decreases	No city's aid can decrease from the previous year's amount by more than an amount equal to the *lesser* of: • $10 multiplied by the city population; or • 5% of the city's levy in the previous year

[1] To avoid sudden changes in city formula need measures, a city with a population between 2,500 and 3,000 or between 10,000 and 10,500, has a formula need based partially on the formula for its current size and partially on the formula for the cities of the next smaller size.

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