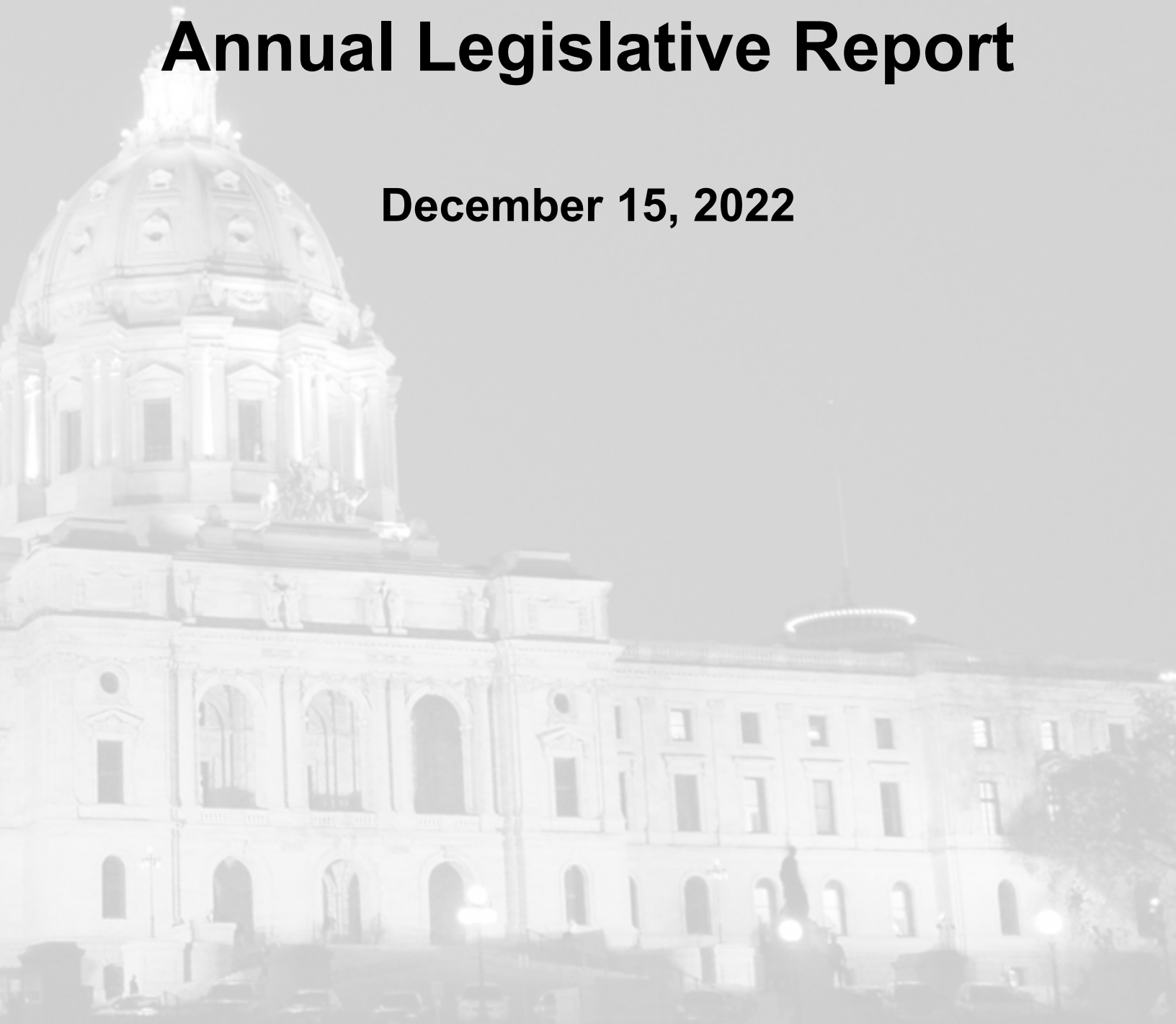


Tax Expenditure Review Commission:

Annual Legislative Report

December 15, 2022



Prepared by the Tax Expenditure Review Commission

For comments questions or concerns please contact the Legislative Budget Office:

100 Rev. Dr. Martin Luther King Jr. Blvd

State Office Building, Room B23

St. Paul, MN 55155

E-mail: lbo@lbo.mn.gov

Phone: 651-297-7146

Cover photograph courtesy of Minnesota House of Representatives Photography.

December 15, 2022

The Honorable Paul Marquart, Chair
Taxes Committee
Minnesota House of Representatives
597 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

The Honorable Carla J. Nelson, Chair
Taxes Committee
Minnesota Senate
3235 Minnesota Senate Building
St. Paul, MN 55155

The Honorable Greg Davids, Minority Lead
Taxes Committee
Minnesota House of Representatives
283 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

The Honorable Ann H. Rest, Minority Lead
Taxes Committee
Minnesota Senate
2217 Minnesota Senate Building
St. Paul, MN 55155

The Honorable Cheryl Youakim, Chair
Property Tax Division
Minnesota House of Representatives
591 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

The Honorable Bill Weber, Chair
Taxes - Subcommittee on Property Taxes
Minnesota Senate
2109 Minnesota Senate Building
St. Paul, MN 5515

The Honorable Jerry Hertaus, Minority Lead
Property Tax Division
Minnesota House of Representatives
389 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

The Honorable Matt D. Klein, Minority Lead
Taxes - Subcommittee on Property Taxes
Minnesota Senate
2409 Minnesota Senate Building
St. Paul, MN 5515

To the Honorable Chairs,

This report is submitted on behalf of the Tax Expenditure Review Commission pursuant to [Minnesota Statutes 3.8855](#), subdivision 7.

The Tax Expenditure Review Commission was created to review Minnesota's tax expenditures and evaluate their effectiveness and fiscal impact. Commission members were appointed in early January and elected a chair and vice chair at the first commission meeting in April. The Tax Expenditure Review Commission must submit an annual report by December 15th to the legislative committees with jurisdiction over tax policy that includes the results of the commission's reviews of tax expenditures in the previous calendar year.

In 2022, the commission began the initial review of current tax expenditures to identify the purpose of each of the state's tax expenditures if none was identified in the enacting legislation, in accordance with [Minnesota Statute 3.192](#). The commission reviewed currently available research on Minnesota tax expenditures, discussed the future evaluation process, and reviewed research on eleven tax expenditures. A proposed objective statement was drafted by the Legislative Budget Office (LBO) for consideration by the commission for each of the eleven tax expenditures reviewed by the commission. The commission has not acted on the presented tax expenditure objective statements.

More detail of the commission's work in its first year is provided within this report.

We want to extend our gratitude to the members of the commission, especially to those who are retiring this year, for their service to the people of Minnesota and their commitment to making our tax code more equitable and transparent. Finally, our heartfelt thanks to the talented and dedicated staff of the Legislative Budget Office for their work supporting the Tax Expenditure Review Commission. We are excited to continue collaborating on this important bipartisan effort.

Sincerely,

A handwritten signature in black ink that reads "Aisha Gomez". The signature is written in a cursive, flowing style.

Representative Aisha Gomez, Chair

A handwritten signature in black ink that reads "Ann H. Rest". The signature is written in a cursive, flowing style.

Senator Ann H. Rest, Vice Chair

Table of Contents

EXECUTIVE SUMMARY	6
Introduction	7
Tax Expenditure Review Commission	9
Commission Members	9
Duties and Responsibilities	10
2022 Commission Meetings	11
Tax Expenditure Overview	12
Tax Expenditure History	12
Minnesota Tax Expenditures	13
Evaluation	20
Purpose Statements in Current Law	23
Proposed Tax Expenditure Objectives	24
References	30
Appendix A: Glossary	32
Appendix B: 2022 Initial Tax Expenditure Reviews	34

Executive Summary

This report is submitted on behalf of the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#), subdivision 7.

Members of the Tax Expenditure Review Commission were appointed in early January 2022 and the inaugural commission meeting was convened on April 19, 2022. The commission has initiated its duty of performing an initial review of current tax expenditures to identify the purpose of each of the state's tax expenditures if none was identified in the enacting legislation in accordance with section 3.192.

Leading up to an initial review, the commission received testimony from experts in the areas of economics, tax research, and tax expenditure evaluations. These early commission meetings provided a baseline understanding of the environment and context surrounding tax expenditures in the state of Minnesota.

The commission confirmed a research methodology for legislative staff to adopt and carry out throughout the course of an initial review. The Legislative Budget Office provides technical and professional support to the commission in this respect.

An initial review was performed on eleven tax expenditures and those results were provided to the commission. An objective statement was drafted for each tax expenditure for the consideration of the commission. These objective statements were informed by a review of the legislative record, comparable policies adopted in peer states, and academic and industry consensus. Potential methods for evaluating each tax expenditure were also identified and shared with commission members.

The commission has not taken action on the eleven tax expenditures objectives presented.

More detail of the work of the commission in its first year is provided within this report.

Introduction

The Tax Expenditure Review Commission was established under 2021 Minnesota Session Laws 1st Special Session, chapter 14, article 11, section 4 to review Minnesota's tax expenditures and evaluate their effectiveness and fiscal impact. Details to the establishment of the commission, its membership, duties, review requirements, staff support, and reporting requirements are codified under Minnesota Statutes, section 3.8855. This report provides an overview of the commission, starting with its membership; the commission's duties and responsibilities; and a summary of the commission's five meetings during calendar year 2022.

The report also includes an overview of tax expenditures and tax expenditure purpose statements that exist in current law, followed by a summary of eleven proposed tax expenditure objectives presented for the consideration of the commission on October 11, 2022. The initial reviews that were distributed to commission members are available in Appendix B. A description of the methodology applied to develop proposed tax expenditure objectives is included in this appendix material.

Under Minnesota Statutes, section 3.8855, subdivision 7, paragraph (b) states that during the period of initial review, under subdivision 4, the commission may limit the contents of a legislative report to the purpose statements and metrics for evaluating the effectiveness of expenditures, as identified by the commission. The commission is within the period of initial review as described in subdivision 4. Therefore, this report is limited to the initial review of eleven tax expenditure objectives presented before the commission in 2022 and their proposed objective statements. A full analysis and evaluation of these tax expenditures has not been performed.

To supplement the report, a general tax expenditure overview is included, which provides a brief history of tax expenditures, a summary of Minnesota's tax system, and considerations for tax expenditure evaluations in the future. Tax terms are defined within the glossary in Appendix A.

The initial work of the commission is grounded in the tax expenditures included in the 2022 Tax Expenditure Budget published by the Minnesota Department of Revenue¹. This report provides the latest estimates for tax expenditures that are most widely leveraged by Minnesota tax filers in the years for which the latest available data exists. The tax expenditure descriptions and fiscal impact estimates included in this report and in the tax expenditure reviews provided to the Tax Expenditure Review Commission are aligned with the descriptions found in the 2022 Tax Expenditure Budget.

¹ (Minnesota Department of Revenue Tax Research Division, 2022)

A note of gratitude is extended to commission members for their participation in the inaugural year the commission. A special acknowledgement goes out to members who will be retiring from their legislative service at the end of this term. Your contributions to the work of the commission are much appreciated.

Additionally, a special thank you goes out to legislative staff and the Department of Revenue for their engagement and feedback that informed the work of the commission throughout the last several months.

Tax Expenditure Review Commission

The structure, duties, and work of the Commission during the 2022 calendar year are outlined below.

Commission Members

2021 Minnesota Session Laws 1st Special Session, chapter 14, article 11, forming the Tax Expenditure Review Commission created a nine-member commission, plus two ex-officio, nonvoting members. Membership is defined in statute as consisting of the following:

- Two members of the Senate appointed by the Senate Majority Leader;
- Two members of the Senate appointed by the Senate Minority Leader;
- Two members of the House of Representatives appointed by the Speaker of the House;
- Two members of the House of Representatives appointed by the Minority Leader;
- The Commissioner of Revenue or a designee.
- If the chair of the house or senate committee with primary jurisdiction over taxes is not an appointed member, the chair is an ex officio, nonvoting member of the commission.

The 2022 Tax Expenditure Review Commission members:

House of Representatives

- Rep. Greg Davids
- Rep. Aisha Gomez, Chair
- Rep. Jerry Hertaus
- Rep. Jennifer Schultz

Senators

- Sen. Thomas M. Bakk
- Sen. Kari Dziedzic
- Sen. Ann H. Rest, Vice-Chair
- Sen. Bill Weber

Department of Revenue

- Assistant Commissioner Jon Klockziem

Ex-Officio Members

- Representative Paul Marquart
- Senator Carla J. Nelson

Duties and Responsibilities

The duties of the commission are defined in Minnesota Statutes, section 3.8855, subdivision 4, including:

- In the first three years after the commission is established, the commission must complete an initial review of the state's tax expenditures. The initial review must identify the purpose of each of the state's tax expenditures if none was identified in the enacting legislation in accordance with Minnesota Statutes, section 3.192. The commission may also identify metrics for evaluating the effectiveness of an expenditure.
- In each year following the initial review, the commission must review and evaluate Minnesota's tax expenditures on a regular, rotating basis.
 - a. The commission must establish a review schedule that ensures each tax expenditure will be reviewed by the commission at least once every ten years.
 - b. The commission may review expenditures affecting similar constituencies or policy areas in the same year, but the commission must review a subset of the tax expenditures within each tax type each year.
 - c. To the extent possible, the commission must review a similar number of tax expenditures within each tax type each year.
 - d. The commission may decide not to review a tax expenditure that is adopted by reference to federal law.
- Before December 1 of the year a tax expenditure is included in a commission report, the commission must hold a public hearing on the expenditure, including but not limited to a presentation of the review components listed in Minnesota Statutes, section 3.8855, subdivision 5.

The Department of Revenue Tax Research Division must provide the commission with the summary data required to complete statutorily required review components.

Legislative Budget Office staff must provide professional and technical assistance to the commission as the commission deems necessary, including assistance with the annual report.

2022 Commission Meetings

The following is a brief discussion of commission activities during 2022. Meeting agendas, minutes, and meeting materials can be found on the [Tax Expenditure Review Commission website](#).

April 2022

The commission elected a chair, Representative Aisha Gomez, and a vice chair, Senator Ann Rest. The commission heard a presentation from House Research and Senate Counsel reviewing the concept of tax expenditures, recent tax expenditure-related legislative activity, and an overview of Minnesota Statutes, section 3.8855.

July 2022

The commission heard presentations from the Minnesota Department of Revenue Tax Research Division and the Minnesota State Economist, Dr. Laura Kalambokidis. Mr. Eric Willette with Tax Research gave an overview of the 2022 Tax Expenditure Budget. Dr. Laura Kalambokidis reviewed the 2011 Tax Expenditure Review Report² and discussed how the reference tax base is defined, the components of a quality tax expenditure review, and developing a review schedule.

August 2022

John Hamman with The Pew Charitable Trusts reviewed how states evaluate tax incentives and use evaluations to inform policy decisions. LBO Lead Budget Analyst, Carlos Güereca, reviewed statutory requirements for the identification of purpose statements, Tax Expenditure Budget criteria, past legislative efforts to identify tax expenditure purpose statements, and the methodology developed by the Legislative Budget Office to identify purpose statements or objectives for commission review.

October 2022

The Legislative Budget Office outlined how staff identify the underlying intent of tax expenditures for the commission to consider in the absence of a purpose statement in statute or session law and presented tax expenditure objective reviews for 11 tax expenditures, further discussed later in this report.

November 2022

The Legislative Budget Office provided a high-level overview of the draft annual legislative report. The Chair and Vice Chair provided an opportunity for additional commission member feedback on the report through November 30th.

² (Blumenthal, et al., 2011)

Tax Expenditure Overview

Tax Expenditure History

Minnesota Statutes, section 270C.11, subdivision 6 defines tax expenditures as follows:

"Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue, but excludes provisions used to mitigate tax pyramiding.

Stanley Surrey, Treasury Assistant Secretary, coined the term "Tax Expenditure" in 1967 to capture "government spending for favored activities or groups, effected through the tax system rather than through direct grants."³ The Congressional Budget Act of 1974 mandated a comprehensive tax budget report on the Federal budgeting process⁴. Minnesota adopted a similar mandate in 1983. The first Tax Expenditure Budget for Minnesota was published in 1985 by the Minnesota Department of Revenue⁵.

Tax expenditures are alternative policy means by which governments deliver financial support to specific activities, entities, or groups of people. A tax expenditure will reduce the reference tax base and cause tax revenue loss in general, assuming the tax rate is held constant⁶.

Many view tax expenditures as forgone revenue. However, estimating the forgone revenue is not as simple as taking the sum of tax expenditure estimates or of tax expenditure claims. Tax expenditure estimates are likely to differ from the amount of revenue receipts that would otherwise be recovered with the repeal of a particular provision. Many variables are at play that may influence how taxpayers or corporations prepare their tax filings in the current tax system. The availability of multiple tax filing options makes it challenging to discern the likely filing decisions of individual filers in the case of a provision's repeal. Such complexities make it so that the assumption that tax expenditure estimates can be interchangeable with estimates of potential revenue receipts to be an incomplete assumption. Nevertheless, the practice of simply aggregating different tax expenditures has been used across published research as a proxy to estimate the magnitude of state fiscal policy.

³ (Surrey & McDaniel, 1985)

⁴ However, a normal or reference tax base to uniformly identify deviations from was not established. See How Specification of the Reference Tax System Affect CBO's Estimates of Tax Expenditures by the Congressional Budget Office.

⁵ After 1996, TEB reports were reported in even years, non-budget years.

⁶ Dept. of Treasury indicates that some tax expenditures can generate tax revenues.

Compared to a traditional direct spending program, tax expenditures have nearly identical effects on the budget, resource allocation, and the distribution of income. The difference is often in who administered the program and the funding structure. Tax expenditures are funded by a reallocation of state resources through the tax system.

As stated in Minnesota Statutes, section 270C.11, subdivision 1.

State governmental policy objectives are sought to be achieved both by direct expenditure of governmental funds and by the granting of special and selective tax relief or tax expenditures.

The Minnesota Tax Expenditure Budget specifies the conceptual basis for determining whether a provision is a tax expenditure. A tax expenditure provision undergoes static scoring to determine the potential impacts for the concurrent fiscal cycle and two future fiscal years. The estimates of fiscal impact along with the legal citation, brief description, and mechanics of administration are reported in the Tax Expenditure Budget.

Although the Tax Expenditure Budget estimates how much money is being spent through particular provisions in the state budgeting process, the report is not intended to answer traditional budget and spending questions regarding how this money is distributed among beneficiaries, whether the expenditure is achieving its intended goal, and whether the expenditure is the best means of achieving that goal. An additional level of analysis is necessary to address these questions.

To improve oversight of tax expenditures, a tax expenditure review report was requested by the Minnesota legislature from the Department of Revenue under Minnesota Laws 2010, chapter 389, article 10, section 5. This resulted in the 2011 report titled “Tax Expenditure Review Report: Bringing Tax Expenditures into the Budget Process” published by the Department of Revenue with the assistance of several academic and policy experts. Recommendations from that report can be identified in the formation of the Tax Expenditure Review Commission in 2021. The commission was established to review Minnesota's tax expenditures and evaluate their effectiveness and fiscal impact.

Minnesota Tax Expenditures

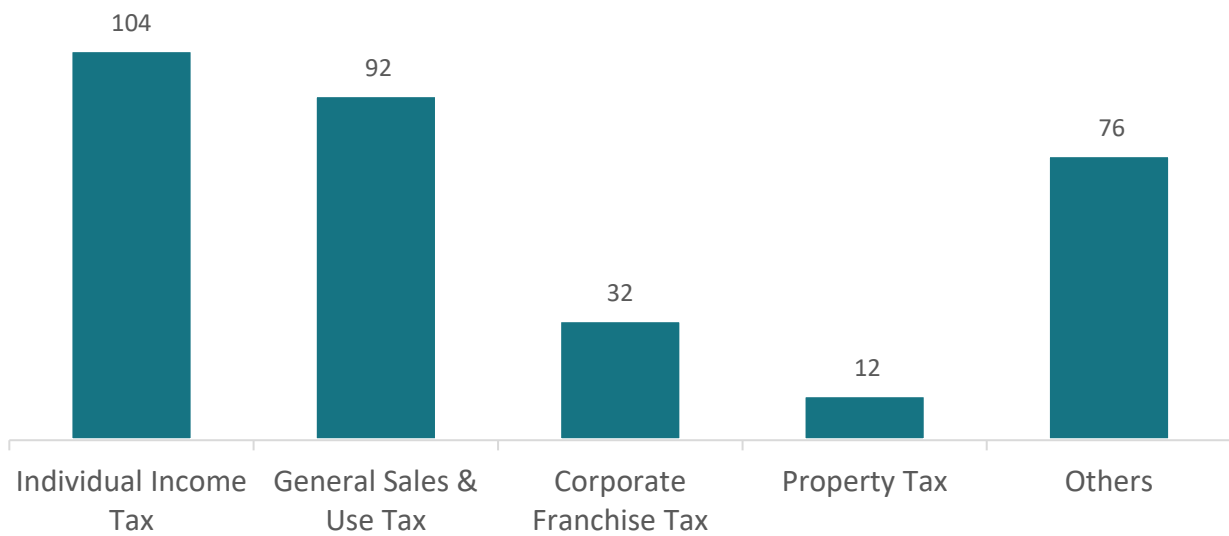
Even though adding tax expenditures together raises many issues, a simple addition of tax expenditures allows us to visualize the magnitude of tax expenditures. An analysis on Summary List data of tax expenditure estimates⁷ included in the 2022 Tax Expenditure Budget, suggests that the state of Minnesota forgoes approximately \$39 billion in state and local tax revenue through the implementation of tax expenditures in

⁷ (Minnesota Department of Revenue Tax Research Division, 2022)

the FY2022-23 biennium. This sum is equal to 61% of the current biennium tax revenue estimate based on 2022 end-of-session tax revenue estimates⁸. These numbers do not include those tax relief policies listed as line items in the state’s direct spending appropriations.

The Department of Revenue identifies 316 tax expenditures in the 2022 Tax Expenditure Budget. Individual Income Tax as a tax type has the highest number of different tax expenditures utilized according to the latest report with 104. It is followed by General Sale & Use Tax with 92, and Corporate Franchise Tax with 32. Figure 1 illustrates the distribution of tax expenditure provisions across tax types. Keep in mind, the “other” category accounts for eleven other tax types reported in the 2022 Tax Expenditure Budget.

Figure 1: Count of Tax Expenditure Provisions by Tax Type
Source: Minnesota 2022 Tax Expenditure Budget



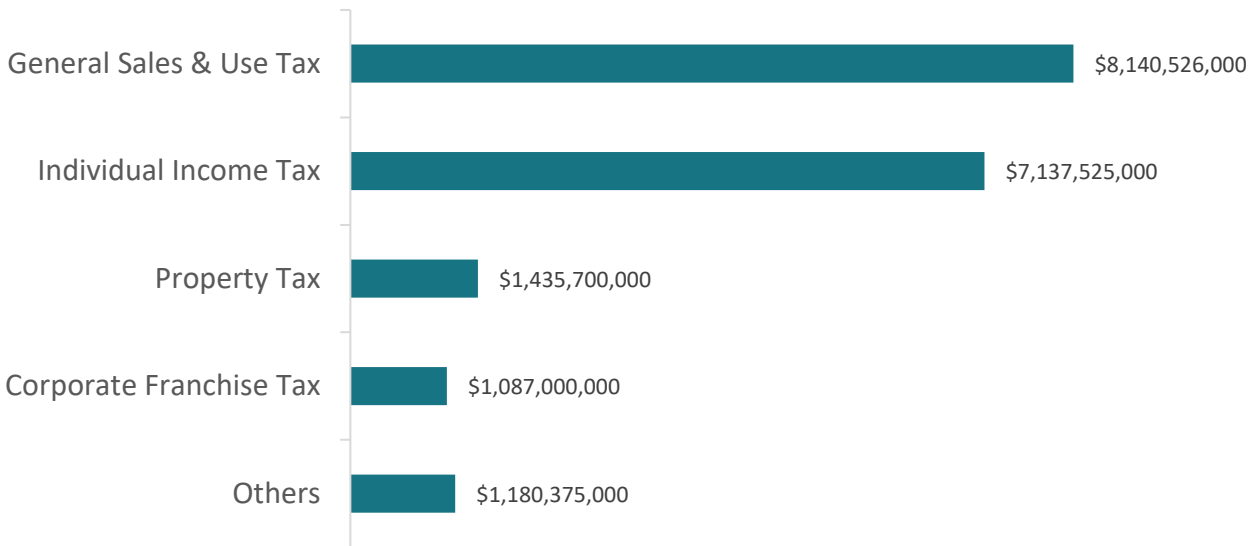
At \$8.1 billion, General Sale & Use Tax incurs the most revenue forgone in terms of dollar amount. Individual Income Tax is second at \$7.1 billion. Individual Income Tax expenditures grow at a projected rate of 7-8% annually. General Sales and Use tax expenditures grow at a rate of 4% then trail off to around 2%. Property tax expenditures grow at approximately 1-2%. Even though Corporate Franchise Tax expenditure starts with the growth rate of 4% in 2023, the projected growth rate increases to 19% in 2024. See a distribution of fiscal year 2022 forgone revenue estimates by tax type in Figure 2.

⁸ See Consolidated Fund Statement – End of 2022 Legislative Session (2022). <https://mn.gov/mmb-stat/documents/budget/operating-budget/enacted/2022/eos22-cfs.pdf>

Tax expenditure estimates are for illustrative purposes only and actual revenue impacts are likely smaller due to tax impact interactions.

Figure 2: Tax Expenditure Estimates by Tax Type in Fiscal Year 2022

Source: Minnesota 2022 Tax Expenditure Budget



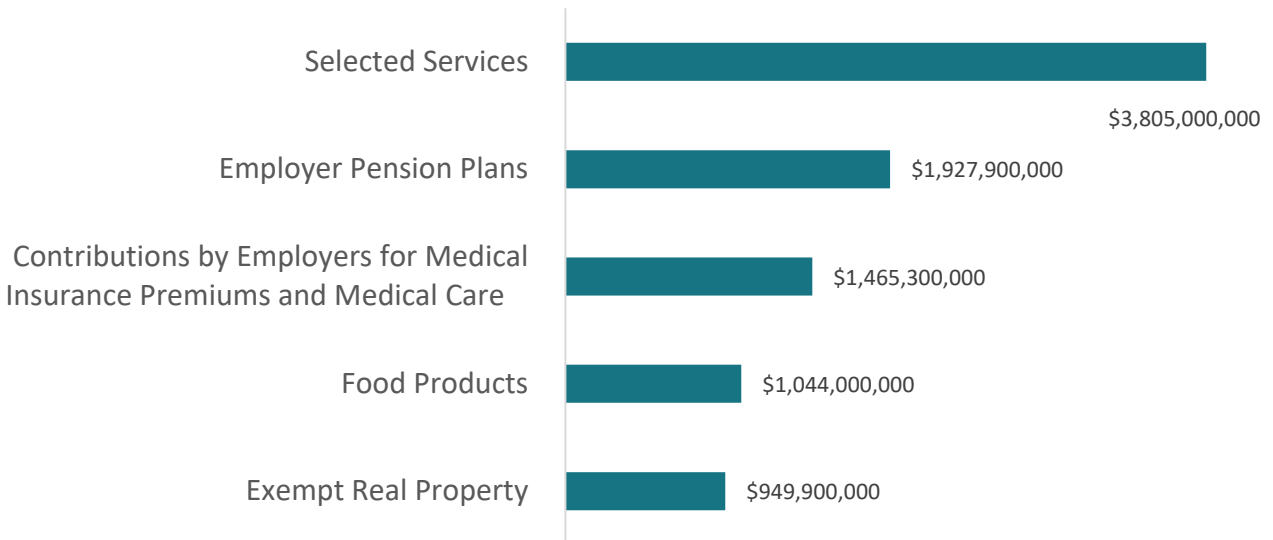
The composition of Minnesota tax expenditures reflects many tax expenditure provisions with comparatively small fiscal impacts and a very few amount of tax expenditure provisions with large estimated fiscal impacts. To help illustrate this further, 93%, or 294 of the 316 tax expenditures included in the 2022 Tax Expenditure Budget, are estimated below \$140 million.

The “Selected Services” tax expenditure is estimated to incur the highest revenue forgone estimated at \$3.8 billion in fiscal year 2022. “Selected Services” is part of the General Sales and Use tax-type and includes a variety of business and consumer purchases such as legal services, management consulting, personal care, repair and maintenance, to name a few. Services exempt from General Sales and Use Tax are defined in Minnesota Statutes, section 297A.61, subdivision 3. The second and third largest tax expenditure estimates for fiscal year 2022 fall under the Individual Income tax-type, “Employer Pension Plans” estimated at \$1.9 billion and “Contributions by Employers for Medical Insurance Premiums and Medical Care”⁹ estimated just under \$1.5 billion. “Contributions by Employers for Medical Insurance” is also a federal conformity tax expenditure. “Food Products” is another General Sales and Use Tax expenditure and the fourth largest tax expenditure estimated at \$1 billion for fiscal year 2022. “Exempt Real Property” (not otherwise exempt from property tax in Federal law or

⁹ Many argue that both provisions should be a consumption tax. Provisions, like these, make Minnesota individual Income tax base a hybrid of income and consumption tax system.

the Minnesota Constitution) is the fifth largest estimated tax expenditure for fiscal year 2022 at just under \$1 billion. A visual comparison of these top five tax expenditure estimates is provided in Figure 3.

Figure 3: Top Five Tax Expenditure Estimates in Fiscal Year 2022
 Source Minnesota 2022 Tax Expenditure Budget



General Sales and Use Tax Expenditure

Minnesota is one of 46 states¹⁰ that levies a sale and use tax. The state has collected a sales tax under Minnesota Statutes, section 290A and section 295.75 since 1967.

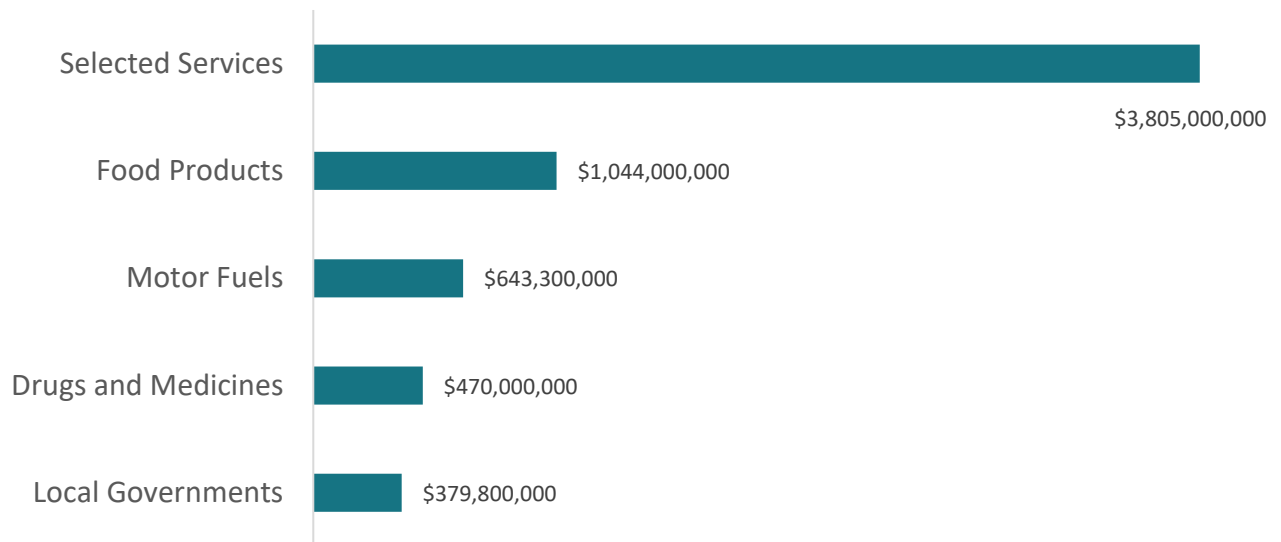
The tax base consists of the gross receipts from the sale of tangible personal property or services to the final user. It is considered a consumption tax in terms of reference tax system¹¹.

Purchasers or users of taxable goods and services are subject to the tax. Holders of sales and use tax permits collect and remit the tax. Holders of direct pay permits remit the tax directly. The state’s five largest general sales and use tax expenditure estimates are illustrated in Figure 4.

¹⁰ Washington D.C. also levies a sales and use tax.

¹¹ See Congressional Budget Office Publication, “How Specifications of the Reference Tax System Affect CBO’s Estimates of Tax Expenditures.”

Figure 4: Top Five General Sales and Use Tax Expenditure by Dollar Amount in Fiscal Year 2022
 Source: Minnesota 2022 Tax Expenditure Budget



Minnesota has a relatively high sales and use tax, with the state tax rate at 6.875% and average of 7.49% state and local tax. The 2021 Minnesota Tax Incidence Study¹² showed that general sales and use tax are considered regressive. An analysis by the Minnesota House Research and Fiscal Analysis Departments provides that “the sales tax burden as a percentage of income falls steadily from 7.5% of total income for the poorest fifth Minnesota households to 1.8% of income for the richest fifth of Minnesota households.¹³”

By far, general sales and use tax expenditures incur the largest revenue forgone or tax benefits to consumers, at an estimated \$8.1 billion. Many tax exemptions for items such as “Selected Services”, “Food Products”, “Clothing”, and “Drugs and Medicines”, among others, were enacted along with sales and use tax in 1967. Since then, they act as a counterbalance to reduce the regressivity of sale tax, and work to achieve a saving-consumption neutrality in terms of reference tax system.

Sales and use tax and tax expenditures affect the relative prices of goods and services. The tax burden or benefit can be transmitted out of Minnesota through tax exporting. The 2021 Minnesota Tax Incidence studies shows that 23% of sale tax burden was shifted to other states in 2018.

¹² (Minnesota Department of Revenue Tax Research Division, 2021)

¹³ (Williams, Klemens, Haigler, & Templin, 2021)

Individual Income Tax Expenditure

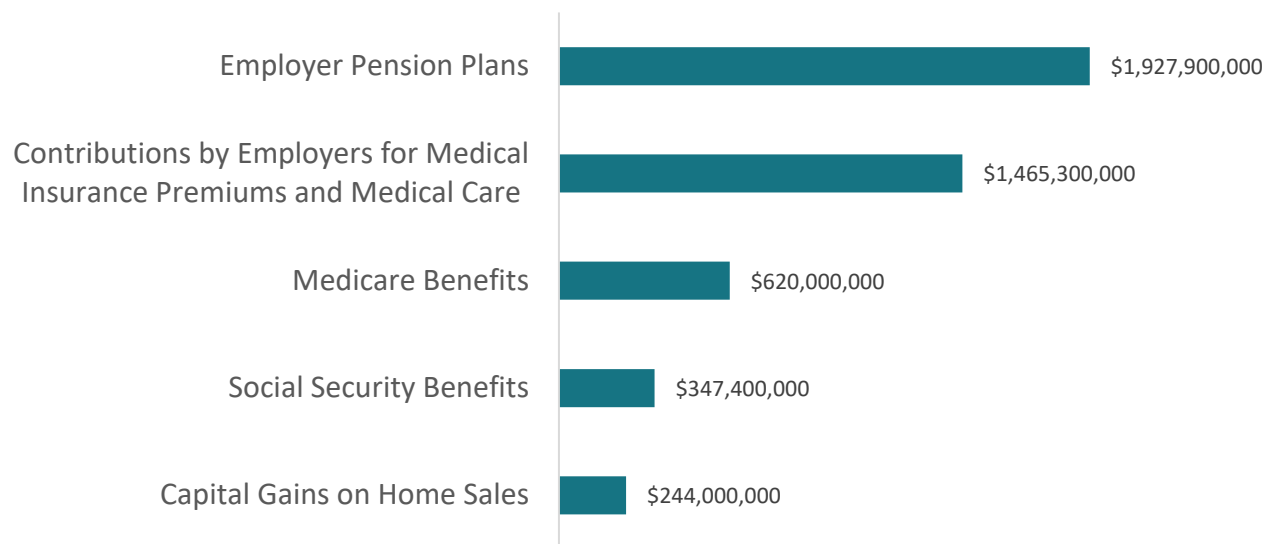
Minnesota individual income tax was enacted in 1933 and structurally remained unchanged through 1984. More recently, in 2019 Minnesota reverted to Federal Adjusted Gross Income (FAGI) as the starting point for the individual income tax calculation. State additions and subtractions are applied and then a progressive graduated tax rate structure is imposed on income thresholds. Minnesota established its own standard and itemized deductions in 2019.

The tax base consists of the FAGI modified by state additions, exemptions, and subtractions. This tax falls on individual taxpayers and a trust or estate with income which meets or exceeds the filing requirements.

Minnesota is a “static date” conformity state. It must regularly adopt changes to keep up with the changes in the federal tax. Many individual income tax expenditures are adopted as federal conformity provisions. There are 61 individual income tax expenditures in the category of “Federal Deduction” and “Federal Exclusion”. The top five largest tax expenditures under the individual income tax types are all federal conformity provisions. The fiscal estimate of these provisions is illustrated in Figure 5.

Figure 5: Top Five Federal Conformity Individual Income Tax Expenditure Estimates by Dollar Amount in Fiscal Year 2022

Source: Minnesota 2022 Tax Expenditure Budget



Forty-three individual income tax expenditures are state discretionary items. Of these, 12 tax expenditures are nonrefundable credits and nine are refundable credits. The 2021 Minnesota Tax Incidence Study shows that the refundable income tax credits substantially reduce overall regressivity of MN tax system. Refundable low-income

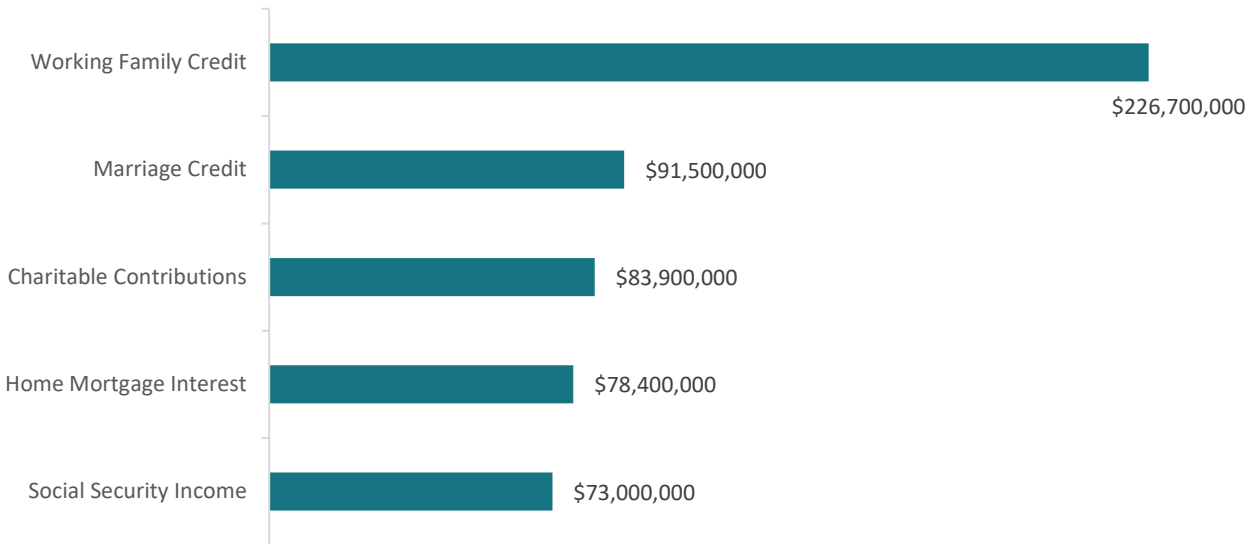
credits cause the effective tax rate for the first two lowest income deciles to be negative. This reduction effect on the effective tax rate from refundable credits starts tapering off in the third decile and completely fades out at the sixth decile. Not all individual income tax expenditures are credits. Figure 6 provides a count of individual income tax expenditures by provisions type and includes those that are federal conformity provision types.

Figure 6: Count of Individual Income Tax Expenditures by Provision Type
Source: Minnesota 2022 Tax Expenditure Budget

Provision Type	Count of Individual Income Tax Expenditures
Credit	21
Deduction	07
Federal Exclusion	40
Federal Deduction	21
Preferred Computation	01
Subtraction	14

Further, Figure 7 provides the revenue loss estimate of the top five individual income tax expenditures that are discretionary policies of the state of Minnesota.

Figure 7: Top Five State Discretionary Individual Income Tax Expenditures by Dollar Amount in Fiscal Year 2022
Source: Minnesota 2022 Tax Expenditure Budget

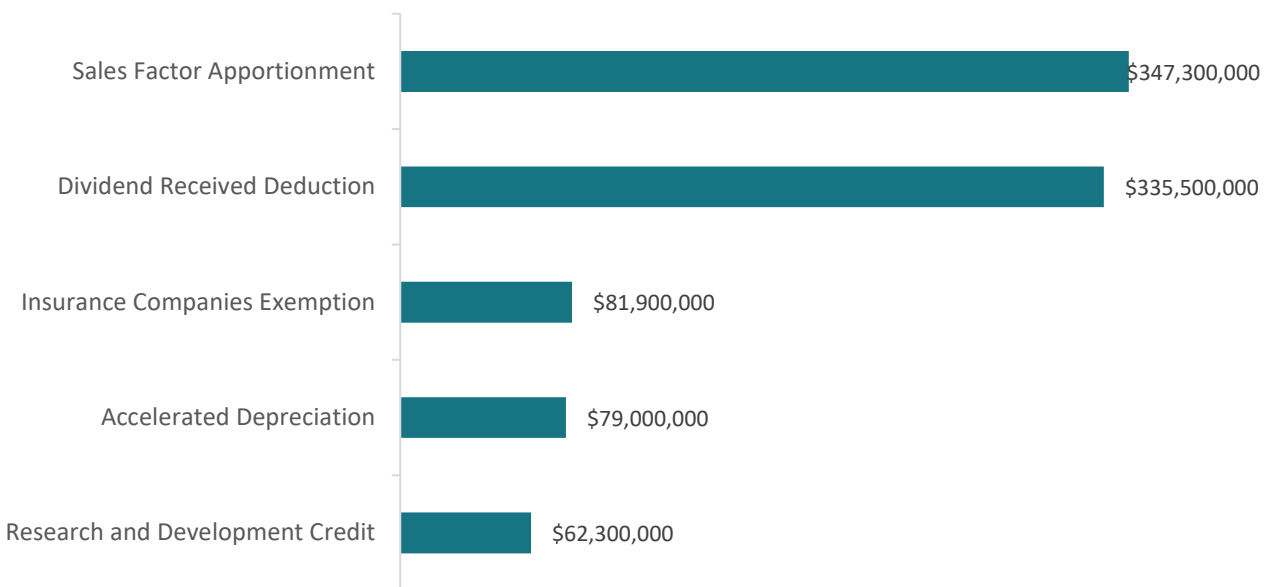


Corporate Franchise Tax Expenditure

The corporate franchise tax was enacted in 1933 along with individual Income tax. A tax rate of 9.8% has been in effect on Minnesota taxable corporate income since 1990. The State of Minnesota adopted an 8-year phase-in of 100% sales apportionment in 2005. Under Laws of Minnesota 2019, 1st Special Session chapter 6, article 1, the state partially conformed to the Federal Tax Cuts and Jobs Act (TCJA) with respect to base-broadening provisions relating to the business interest deductions, net operating loss limits, and employer deduction limits.

Domestic and international corporations and financial institutions that have nexus, physical or economic presence in the state of Minnesota, bear this tax liability on income that excludes expenses considered to be reasonable and necessary to generate that income.

Figure 8: Top Five Corporate Franchise Tax Expenditures by Dollar Amount in Fiscal Year 2022
Source: Minnesota 2022 Tax Expenditure Budget



Evaluation

As an integral part of the tax system, tax expenditures affect the distribution of income and influence how people work, save, and invest. Evaluation due diligence becomes essential to ensure that tax expenditures constitute sound public policy and meet the objectives for which they were created.

At the federal level, the Joint Committee on Taxation and the Congressional Budget Office (CBO) dedicate considerable resources to analyzing tax expenditures. The

Department of Treasury and the Internal Revenue Service also perform evaluations of tax expenditures. Many studies on tax expenditures are based on the Internal Revenue Service Data Book, [SOI Tax Stats-IRA Data Book](#). This resource provides rich information on individual income data, based on a sample drawn from individual income tax returns. Estimates on sources of income, exemptions, deductions, credits, taxable income, federal and state income tax, tax credits, are provided. Classifications include tax status, size of adjusted gross income, marital status, age, and type of tax computation. Other important data resources readily available to the Tax Expenditure Review Commission include the American Communities Survey, the Quarterly Census of Employment and Wages and aggregate tax return data from the Minnesota Department of Revenue.

Many states have established a formal tax expenditure evaluation policy, typically revisiting them at least once every eight years. In some cases, the circumstances might trigger a special review on a particular tax expenditure. More than half the states have completed evaluations on selected tax expenditures, with some more comprehensive than the others. The state of Minnesota conducted several in-depth analyses on select tax expenditures in the past, such as the Small Business Investment Tax Credit (Angel Tax Credit)¹⁴, the Research Tax Credit, and the Minnesota Historic Rehabilitation Tax Credit¹⁵. These evaluations will provide strong guidance to the commission once it enters the phase of full analysis.

The enacting legislation of the Tax Expenditure Review Commission, Minnesota Statutes, section 3.8855, provides the commission with nine components that must be reviewed under a full analysis. The review components can be categorized under three primary components that a tax expenditure evaluation should consider.

Performance measurement: What was the tax expenditure's performance? Is the expenditure achieving its intended goal? How does it affect tax equality, efficiency, and administrative simplicity?

Performance attribution: How was the performance achieved? How is this tax return distributed among beneficiaries?

Performance appraisal: Is the expenditure the best means of achieving its intended goal?

Addressing these components on their own and the relationships between them will prepare the commission with valuable information so it can provide well-informed recommendations to the legislature. The general approaches to an evaluation include a

¹⁴ See 2014 report by Economic Development Research Group, Inc and Karl F. Seidman Consulting Services provided to the Minnesota Department of Revenue.

¹⁵ See 2021 report prepared by the University of Minnesota Extension on behalf of the State Historic Preservation Office at the Minnesota Department of Administration.

qualitative analysis, such as participant surveys, or a quantitative analysis consisting of a descriptive statistical analysis or a more complex econometric analysis. The choice among evaluation techniques is subject to the specific question at hand and the availability of information and data. Many tax expenditures are enacted with a unique legislative history and under specific circumstances. These factors should be considered as well to the best degree possible to provide a comprehensive assessment.

Purpose Statements in Current Law

There are 104 tax expenditures with a purpose statement recorded in current statute or session law. Of these 104 tax expenditures, seven purpose statements are codified in Minnesota statute. This includes one corporate franchise tax subtraction, two general sales and use tax exemptions, one property tax exemption, and three property tax preferential computations. These seven tax expenditures are discretionary tax policies of the state and not originated to conform with the federal tax code.

Ninety-seven tax expenditures have a purpose statement that exists in session law. Of these, 81 tax expenditures have been adopted to fully or partially align with federal deductions or exclusions. Sixteen purpose statements exist in session law for tax expenditures that are discretionary tax policies of the state and not originated to conform with the federal code.

As the legislature has identified a purpose statement in law for these 104 tax expenditures, the commission may limit its initial review of these provisions to possible metrics for evaluating the effectiveness of the individual policies. Additionally, the commission may also choose to exclude any or all provisions if adopted to be in Federal conformity.

The next section provides a brief overview of the eleven tax expenditures that were presented to the Tax Expenditure Review Commission under an initial review. These presentations included a proposed objective statement for the commission to consider to fulfill its requirement to identify a purpose statement.

Proposed Tax Expenditure Objectives

On October 11th, 2022, eleven tax expenditures were presented to the Tax Expenditure Review Commission along with a proposed objective of the tax expenditure. Proposed tax expenditure objectives were drafted based on the process presented to the commission in August that included a review of the legislative record, prior author testimony, or analysis of comparable policy in peer states. Currently, no action has been taken by the commission to adopt or amend any of the proposed objectives for consideration. A brief description is provided of each tax expenditure objective presented to the commission, aligned to the descriptions in the Department of Revenue's 2022 Tax Expenditure Report.

Working Family Credit

Minnesota Statutes 2021, section 290.0671

The Minnesota working family credit is a refundable credit against the individual income tax allowed to taxpayers who are eligible for the federal earned income credit. To qualify, the taxpayer (or spouse) must have income from wages or self-employment, and total earned income (or adjusted gross income, whichever is larger) cannot exceed a maximum amount. A taxpayer is not eligible if investment income exceeds a specified amount (\$3,800 for tax year 2022).

Proposed Tax Expenditure Objective for Consideration

The objective of the working family credit is to encourage work and help families raise their income above the poverty guideline levels.

Beginning Farmer Management Credit

Minnesota Statutes 2021, section 290.06, subdivision 38

The beginning farmer management credits is a nonrefundable credit eligible for beginning farmers participating in a financial management program approved and certified by the Minnesota Rural Finance Authority. The credit is equal to the cost of participating in the program, up to \$1,500 per year. The credit may be taken for up to three years while the farmer is in the program. Any unused credit may be carried forward for up to three years. The credit is set to expire after 2023.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer management credit is to incentivize beginning farmers to participate in a financial management program approved by the Rural Finance Authority to improve the farming operation success rate in the state of Minnesota.

Beginning Farmer Incentive Credit

Minnesota Statutes 2021, section 290.06, subdivision 37 and section 41B.0391

The beginning farmer incentive credit is a nonrefundable credit available to taxpayers who sell or rent agricultural assets to a beginning farmer. The amount of the credit varies depending on factors such as the sale price or market value of an asset or on a percentage of gross rental income depending on the terms of a rental agreement. The credit will expire after 2023.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer incentive credit is to lower the barrier of entry for a beginning farmer and make them more financially competitive.

Research and Development Credit

Minnesota Statutes 2021, section 290.068

Minnesota businesses who conduct research and development within the state can claim a nonrefundable credit against the corporate income tax or individual income tax (in the case of LLCs and S corporations) for certain qualified expenditures related to business activities such as wages, costs of supplies, computer costs, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

Proposed Tax Expenditure Objective for Consideration

The objective of Research and Development Credit is to create or retain jobs, increase research activity, and attract or retain business in Minnesota.

Employer Transit Pass Credit

Minnesota Statutes 2021, section 290.06, subdivision 28

The employer transit pass credit is allowed against the corporate franchise tax equal to 30% of the expense incurred by the taxpayer to provide transit passes to the taxpayer's employees. The transit passes must be for use in Minnesota and the expenses used for the credit is the difference the employer paid for the passes and the amount charged to their employees.

Proposed Tax Expenditure Objective for Consideration

The objective of the Employer Transit Pass Credit is to incentivize Minnesota employers to subsidize transit passes for their employees to encourage the use of public transit.

Housing Contribution Credit

Minnesota Statutes 2021, section 290.0683 and section 462A.40

A nonrefundable credit is allowed for contributions to a designated account in the Housing Development Fund administered by the Minnesota Housing Finance Agency (MHFA). Statute specifies that contributions are to be used for grants and loans for low to moderate income housing developments. Both individuals and businesses can make contributions to reduce their personal income, franchise, or insurance premium tax liability. The credit was enacted in 2021 and is effective for tax years 2023 through 2028.

Proposed Tax Expenditure Objective for Consideration

The objective of the Minnesota Housing Tax Credit is to increase the development and availability of affordable housing to persons and families of low and moderate incomes in Minnesota.

Telecommunications Equipment Exemption

Minnesota Statutes 2021, section 297A.68, subdivision 35a

An exemption from the sales and use tax is allowed for telecommunications, cable television, and direct satellite equipment purchased or leased for use directly by a telecommunication, cable television, or direct satellite service provider in providing telecommunications services that are ultimately sold at retail. This exemption was enacted in 2001. In 2013, the exemption was repealed, effective July 1, 2013. In 2014, the exemption was reinstated, effective April 1, 2014. The exemption was expanded to include fiber and conduit in 2017.

Proposed Tax Expenditure Objective for Consideration

The tax expenditure objective of the Telecommunications Equipment Exemption is to reduce potential tax pyramiding and promote transparency in the tax system by exempting telecommunications equipment that is used to provide taxable telecommunications services.

The tax expenditure objective of the 2017 amendment to the Telecommunications Equipment Exemption that expanded the definition of “telecommunications or pay television machinery and equipment” to include fiber and conduit is to increase the deployment and accessibility of broadband internet service in Minnesota.

Solar Energy Systems

Minnesota Statutes 2021, section 297A.68, subdivision 12

The solar energy systems tax expenditure is a sales tax exemption on solar energy system devices meant to collect solar energy, convert it, store it, and use it for a variety of purposes that include heating, cooling, and other energy-producing processes or to produce generated power as a means of collecting, transferring, or converting solar-generated energy.

Proposed Tax Expenditure Objective for Consideration

The objective of the solar energy systems general sales and use tax exemption is to incentivize and promote the implementation and utilization of solar energy systems in the state of Minnesota to achieve a greater percentage of renewable energy contributions to the state's electricity fuel generation mix.

Farm Machinery Exemption

Minnesota Statutes 2021, section 297A.69, subdivision 4(1)

This exemption from Minnesota sales and use tax applies to farm machinery and equipment used directly in the agricultural production of tangible personal property intended to be sold at retail. Qualifying farm machinery includes machinery, equipment, implements, and accessories used directly and principally in the production for sale of agricultural products, including livestock, and irrigation systems.

Proposed Tax Expenditure Objective for Consideration

The objective of the farm machinery exemption is to reduce potential tax pyramiding and promote transparency in the tax system by exempting machinery and equipment used directly in the agricultural production of tangible personal property ultimately intended to be sold at retail.

Building Materials for Residences of Disabled Veterans

Minnesota Statutes 2021, section 297A.71, subdivision 11

Building materials used to construct or remodel the residence of a disabled veteran are exempt from the sales and use tax. The exemption applies if the project is financed in whole or in part by the U.S. Government in accordance with United States Code, Title 38, Sections 2101 to 2105.

Proposed Tax Expenditure Objective for Consideration

The objective of the building materials exemption for residences of disabled veterans is to provide specific sales and use tax relief to disabled veterans who have been awarded a federal grant for the construction or remodeling of their homes, ensuring that disabled veterans receive the full financial benefit of the federal program.

Construction Materials for Certain City Projects (TEB 4.73)

Minnesota Statutes 2021, section 297A.71, subdivision 44 and section 297A.9905

This is an exemption from Minnesota sales and use tax for materials, supplies, and equipment incorporated into the construction or improvement of a capital project funded partially or wholly by a city as a means of providing indirect assistance to local governments for certain city projects. Additionally, project funding must be drawn from the excess revenues generated by a local tax on retail sales. There are a few other specifics as to what kind of capital projects qualify generally, the project must involve the construction or renovation of a sports facility, a convention or civic center.

Proposed Tax Expenditure Objective for Consideration

The objective of the sales tax exemption for construction materials for certain city projects is to provide an indirect means of assistance to local governments for capital projects funded wholly or partly by excess local tax revenues imposed under special law.

References

- Blumenthal, M., Kalambokidis, L., Kiedrowski, P. J., Spry, J., Temple, J., Wahl, J., & Revenue, M. D. (2011). *Tax Expenditure Review Report: Bringing Tax Expenditures Into the Budget Process*. St. Paul: Minnesota Department of Revenue.
- Congressional Budget Office. (2022, November 04). *How Specifications of the Reference Tax System Affect CBO's Estimates of Tax Expenditures*. Retrieved from Publications: <https://www.cbo.gov/publication/57695>
- Economic Development Research Group and Karl F. Seidman Consulting Services. (2014). *Evaluation of the Minnesota Angel Tax Credit Program: 2010-2012*. St. Paul: Department of Revenue.
- Eissa, N., & Liebman, J. B. (1995). *Labor Supply Response to the Earned Income Tax Credit*. Cambridge: The MIT Press.
- Minnesota Department of Management and Budget. (2022). *Consolidated Fund Statement: Budgetary Basis End of 2022 Legislative Session*. St. Paul: Minnesota Management and Budget.
- Minnesota Department of Revenue. (2021, August). Auditor/Treasurer Manual. St. Paul, Minnesota.
- Minnesota Department of Revenue. (2022, November 16). *Property Tax Programs*. Retrieved from Minnesota Department of Revenue: <https://www.revenue.state.mn.us/property-tax-programs>
- Minnesota Department of Revenue. (2022, November 16). *Subtractions and Deductions*. Retrieved from Minnesota Department of Revenue: <https://www.revenue.state.mn.us/subtractions-and-deductions>
- Minnesota Department of Revenue Tax Research Division. (2021). *2021 Minnesota Tax Incidence Study: An Analysis of Minnesota's Household and Business Taxes*. St. Paul: Minnesota Department of Revenue.
- Minnesota Department of Revenue Tax Research Division. (2022, November 15). *2022 Summary List*. Retrieved from <https://www.revenue.state.mn.us/tax-expenditure-reports>

- Minnesota Department of Revenue Tax Research Division. (2022). *State of Minnesota Tax Expenditure Budget Fiscal Years 2022-2025*. St. Paul: Minnesota Department of Revenue.
- Minnesota Office of the Legislative Auditor. (2017). *Minnesota Research Tax Credit*. St. Paul: State of Minnesota.
- Stupak, J. (2019). *Introduction to U.S. Economy: The Business Cycle and Growth*. Washington D.C.: Congressional Research Service.
- Surrey, S., & McDaniel, P. (1985). *Tax Expenditures*. Cambridge, MA: Harvard University Press.
- Talvi, E., & Vegh, C. (2000). *Tax Base Variability and Procyclical Fiscal Policy*. Cambridge: National Bureau of Economic Research.
- Tuck, B., & Foss, N. (2022). *Economic Impact of Projects Leveraged by the Minnesota Historic Rehabilitation Tax Credit: Fiscal Year 2021*. St. Paul: University of Minnesota Extension.
- Wiehe, M., Davis, A., Davis, C., Gardner, M., Christensen Gee, L., & Grundman, D. (2018). *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States*. Washington D.C.: The Institute on Taxation and Economic Policy.
- Williams, S., Klemens, C., Haigler, A., & Templin, C. (2021). *Overview of Income, Corporate, Sales and Other State Taxes: Background information for Members of the House Committee on Taxes*. St. Paul: Minnesota House of Representatives Research and Fiscal Analysis Departments.

Appendix A: Glossary

This glossary provides definitions for terms that have been previously defined in Minnesota Statutes, Minnesota Department of Revenue published reports, federal agency reports, or industry reference materials. See references and links to source materials.

Business Tax Credit - Minnesota Statute, section 270C.11, subdivision 6(1):

A credit against the corporate franchise tax claimed by a C corporation; or a credit against the individual or fiduciary income tax claimed by a pass-through entity that is allocated to its partners, members, or shareholders.

Deductions - Also called Subtractions for Minnesota tax purposes, are income tax provisions that reduce the amount of individual or business income that is taxable. For examples of Minnesota deductions and subtractions, see Department of Revenue Subtractions and Deductions webpage <https://www.revenue.state.mn.us/subtractions-and-deductions>.

Effective Tax Rate - The percentage of taxable income that an entity pays to meet their tax liability.

Exclusions - Property tax provisions that lower tax liability by subtracting the amount of the exclusion from the property's estimated market value to arrive at a lower taxable market value. For examples of Minnesota exclusions, see the Department of Revenue's Property Tax Program webpage at <https://www.revenue.state.mn.us/property-tax-programs>.

Nonrefundable Credit - a credit allowed towards an individual's tax liability. Any credit amount that exceeds the tax liability is forgone by the individual and not returned to the individual through a refund.

Normal Tax Bases - "a reference tax system reflects a particular conceptual basis for taxation as well as other features necessary to implement and administer the tax code." See additional detail in Congressional Budget Office, 2021.

Progressive Tax - A tax for which the effective tax rate rises as income rises. See 2021 MN Tax Incidence Study.

Significant Tax Expenditure - Minnesota Statute, section 270C.11, subdivision 6(3):

A tax expenditure, but excluding any tax expenditure that:

- (i) is incorporated into state law by reference to a federal definition of income;
- (ii) results in a revenue reduction of less than \$10,000,000 per biennium; or
- (iii) is a business tax credit;

Subtractions - "Allowable deductions to an individuals adjusted gross income. Claiming subtractions reduces your income taxable to Minnesota." For examples of Minnesota deductions and subtractions,

see Department of Revenue Subtractions and Deductions webpage
<https://www.revenue.state.mn.us/subtractions-and-deductions>.

Tax Credits - Directly reduce the amount of tax that would otherwise be owed. A refundable credit may reduce a tax liability to zero and allow the taxpayer to receive a “refund” if the credit amount is greater than the tax amount. A nonrefundable credit may only reduce a tax liability to zero. Minnesota statutes include various credit provisions for income and property taxes. For examples of Minnesota income tax credits, see Department of Revenue Income Tax Credits webpage at <https://www.revenue.state.mn.us/income-tax-credits>. For examples of Minnesota property tax credits, see pages 124-144 of the Department of Revenue Auditor/Treasurer Manual.

Tax Expenditure - Minnesota Statute, section 270C.11, subdivision 6(4):

A tax provision which provides a gross income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue, but excludes provisions used to mitigate tax pyramiding.

Tax Incidence - “The ultimate burden of the tax after the person or business firm legally obligated to pay the tax alters its behavior in response (if it does alter its behavior). In some cases, namely taxes imposed directly on households, both the impact and the incidence are the same. In other cases, such as taxes on businesses, some or all of the incidence may be shifted from the business to others.” See 2021 MN Tax Incidence Study.

Tax Pyramiding - Minnesota Statute, section 270C.11, subdivision 6(6):

Imposing sales taxes under chapter 297A on intermediate business-to-business transactions rather than sales to final consumers.

Refundable Credit - a credit allowed to individuals that may exceed an individual's tax liability, the difference of which is returned to the individual as a refund.

Regressive Tax - A tax for which the effective tax rate falls as income rises. See 2021 MN Tax Incidence Study.

Tax Expenditure Review Commission:

Tax Expenditure Objectives Review

October 11, 2022

(Includes technical corrections since date of presentation)



Introduction

Per Minnesota statute 3.8855, subdivision 4, paragraph (a), the Tax Expenditure Review Commission must complete an initial review of the state's tax expenditures and identify the purpose of each of the state's tax expenditures, if none was identified in the enacting legislation. Under the direction of the Tax Expenditure Review Commission, tax expenditure objectives are prepared for consideration of the commission. This briefing provides an initial review for a selection of tax expenditures and presents potential tax expenditure objectives. Commission members may choose to adopt, modify, or reject the objectives presented in this briefing.

The objectives presented here are informed by a review of the Minnesota legislative record pertaining to each enacted provision, adopted objectives of comparable legislation in other states, and academic and industry consensus. Reference sources are provided for each provision.

The initial review of tax expenditures is focused on identification of objectives; however, methods for evaluating the effectiveness of an expenditure and potential metrics are also suggested. The ability to perform such evaluations and produce such metrics may be limited by the data available at the time a full analysis is conducted.

This briefing is prepared by the Legislative Budget Office for the Tax Expenditure Review Commission. The tax expenditure description, projections of fiscal impact by fiscal year, and reference number for each tax expenditure provision are adopted from the 2022 Tax Expenditure Budget (TEB) prepared by the Department of Revenue. As stated in the preface of the published 2022 TEB report, the projections of fiscal impact reflect Minnesota law after changes enacted in the 2021 Legislative Session. Figures for the most recent estimate of claims and state fiscal impact are provided by DOR. This report was drafted with input from non-partisan legislative fiscal and research staff and the DOR Tax Research Division.

For more information on the Tax Expenditure Review Commission please visit the [Legislative Budget Office website](https://www.lbo.leg.mn/) [https://www.lbo.leg.mn/]

Methodology

This section provides a general overview of the research process taken to identify the proposed tax expenditure objectives and potential metrics for measurement of effectiveness. This research process was designed in consultation with the Minnesota Legislative Reference Library.

The primary source of reference in determining a tax expenditure objective is the enacting legislation for each respective tax expenditure provision. A review of the enacting law and previous engrossments is performed for each tax expenditure to identify an author's reference to the legislation's intent. Additionally, previous committee meetings, floor debates, and meeting minutes are reviewed to ensure a comprehensive assessment. Beyond the enacting legislation and any prior engrossments, previously introduced bills with comparable language are reviewed in the same manner as previously described.

Comparable tax programs across peer states are referenced in cases where a tax expenditure's objective cannot be identified explicitly in the Minnesota legislative record. Components of policy design are considered to ensure appropriate comparisons can be made to programs in other states. Such considerations include intended beneficiary, tax type, and provision type as referenced in the TEB report. The two main resources used to identify such programs include the National Conference of State Legislatures' State Tax Incentive Evaluations Database and the Institute on Taxation and Economic Policy's State-by-State Tax Expenditure Reports.

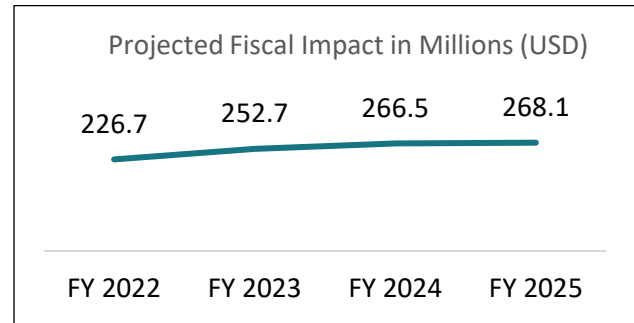
A literature review is performed to gauge the academic and industry consensus regarding the objectives for specific tax policy in cases where an objective cannot be identified by the two methods described above. Additionally, these sources are referenced to identify potential metrics to measure effectiveness and impact. More detail to these findings can be found in each respective provision briefing.

Working Family Credit

Proposed Tax Expenditure Objective Review - TEB 1.90

Tax Expenditure Facts

Year Enacted	1991
Statute	Minn. Stat § 290.0671
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	\$227,191,168 - Tax Year 2020
Latest Claims Estimate	371,570 - Tax Year 2020
Expiration Date	None



Tax Expenditure Description

The Minnesota working family credit is a refundable credit against the individual income tax allowed to taxpayers who are eligible for the federal earned income credit. To qualify, the taxpayer (or spouse) must have income from wages or self-employment, and total earned income (or adjusted gross income, whichever is larger) cannot exceed a maximum amount. A taxpayer is not eligible if investment income exceeds a specified amount (\$3,800 for tax year 2022). Although the Minnesota working family credit generally uses the same eligibility requirements and definitions as the federal earned income credit, the calculation of the state credit is separate.

Additional Background Information

This tax credit is administered by the Department of Revenue. Beneficiaries of this tax expenditure are individuals residing in Minnesota. A part-year resident can apply for a partial credit according to rates specified in law¹. The state fund impacted by this tax expenditure is the state General Fund.

Proposed Tax Expenditure Objective for Consideration

The Objective of the working family credit is to encourage work and help families raise their income above the poverty guideline levels.

Sources

The proposed tax expenditure objective is adopted from A Review of Selected Tax Expenditures² by the Minnesota House Research Department in 2013.

Other Considerations Regarding the Proposed Tax Expenditure Objective

Minnesota House Research cited the same proposed tax expenditure objective in its 2016 report, [the Federal Earned Income Tax Credit and the Minnesota Working Family Credit](#)³, and 2022 report, [the Working Family Credit and Federal Earned Income Credit](#)⁴.

Descriptions to the intent of this tax credit in committee by legislative members align with the proposed tax expenditure objective⁵.

The proposed objective is also reconciled on the federal level. The report done by House Committee on Budget of US Congress, [The Earned Income Tax Credit Boosts Work, Reduces Poverty, and Provides Other Benefits for Working Americans](#)⁶, shared the similar objective. Numerous academic studies and evaluations by other States also collaborated with the proposed sentiment.

Potential Metrics and Performance Measures

The commission can consider an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across income, demographic characteristics (family size, family type), and geography.

Another potential metric is to examine how the poverty level and labor participation rate evolved over time in relation to the participation rate of working family credit recipients.

Economic modelling can be applied to study the short term and long term economic and fiscal impacts of the working family credit.

Contact Information

This proposed tax expenditure objective review was prepared by the Legislative Budget Office for the Tax and Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

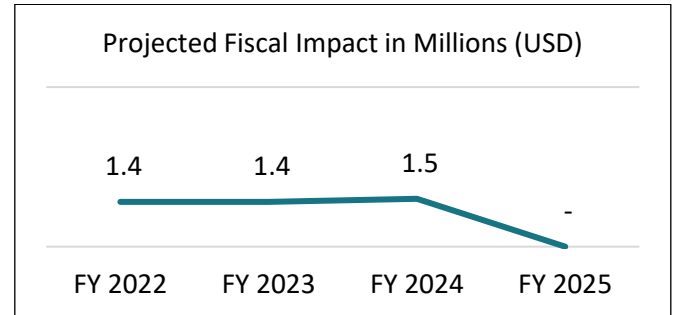
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>

Beginning Farmer Management Credit

Proposed Tax Expenditure Objective Review - TEB 1.103

Tax Expenditure Facts

Year Enacted	2017
Statute	Minn. Stat. § 290.06, Subd.38
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	\$472,457 -Tax Year 2020
Latest Claims Estimate	382 -Tax Year 2020
Expiration Date	2023



Tax Expenditure Description

A beginning farmer may claim a nonrefundable credit for participating in a financial management program approved and certified by the Minnesota Rural Finance Authority. The credit is equal to the cost of participating in the program, up to \$1,500 per year. The credit may be taken for up to three years while the farmer is in the program. Any unused credit may be carried forward for up to three years. The credit was enacted in 2017 and will expire after 2023. Approximately 370 returns claimed this credit in tax year 2020.

Additional Background Information

This tax expenditure is administered by Rural Finance Authority. Beneficiaries of this tax expenditure are the beginning farmers residing in Minnesota. The state fund impacted by this expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer management credit is to incentivize beginning farmers to participate in a financial management program approved by the Rural Finance Authority to improve the farming operation success rate in the state of Minnesota.

Sources

The proposed tax expenditure objective was informed by the relationship of the beginning farmer management credit to the beginning farmer incentive credit. Further, a review of academic literature suggests that improved business planning⁷ and financial management programs⁸ result in higher profitability and financial efficiency for beginning farmers. The logic implied by these studies informs the drafting of the proposed tax expenditure objective, assuming this aligns with the intention of the legislature.

Potential Metrics and Performance Measures

A possible metric for Minnesota's Beginning Farmer Management Credit includes an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across demographics of beginning farmers, experience levels, and locations.

An effectiveness study can be conducted to examine whether participation in financial management programs selected by the Rural Finance Authority led to the successful operations of beginning farmers.

An analysis of registration enrollment for financial management programs approved by the Rural Finance Authority can be performed to gauge whether this incentive has increased participation in the education programs.

Nebraska requires financial management education programs for beginning farmers applying for a beginning farmer tax credit. An [evaluation](#) of that program by the state's Legislative Auditor reports on the number of claims submitted and the total dollar value of approved claims⁹. As participation in the financial management program is required to qualify for the larger Beginning Farmer Tax Credit, it is difficult to assess whether enrollment rates in the education program are impacted by the financial management program credit.

Contact Information

This proposed tax expenditure objective review was prepared by the Legislative Budget Office for the Tax and Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

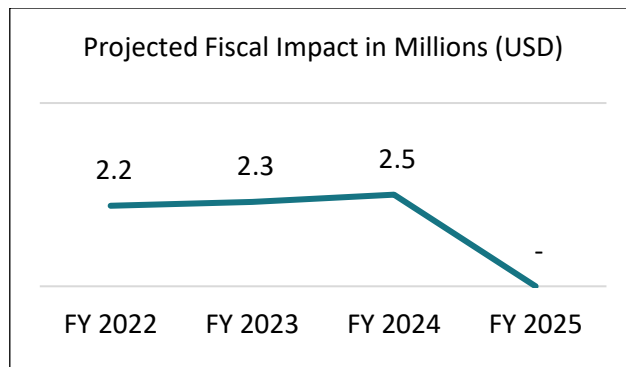
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Beginning Farmer Incentive Credit

Proposed Tax Expenditure Objective Review - TEB 1.104

Tax Expenditure Facts

Year Enacted	2017
Statute	Minn. Stat § 290.06, Subd. 37 and 41B.0391
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	\$2,454,443 – Tax Year 2020
Latest Claims Estimate	620 – Tax Year 2020
Expiration Date	2023



Tax Expenditure Description

A nonrefundable credit is available to taxpayers who sell or rent agricultural assets to a beginning farmer. The credit equals one of the following:

- 5% of the sale price or market value of the asset, up to \$32,000.
- 10% of the gross rental income in each of the first three years of a rental agreement, up to \$7,000 per year; or
- 15% of the cash equivalent of the gross rental income in each of the first three years of a rent-share agreement, up to \$10,000 per year.

Any unused credit may be carried forward for up to 15 years. The total value of credits is capped at \$5 million for 2018 and \$6 million in later years. The credit was enacted in 2017 and will expire after 2023.

Additional Background Information

This tax expenditure is administered by Rural Finance Authority. Beneficiaries of this tax expenditure are asset owners residing in Minnesota, including individual farmers, “pass through” entities, and partnerships. A nonresident or part-year resident can apply for a portion of the credit, using the percentage calculated in section [290.06, subdivision 2c](#), paragraph (e). The state fund impacted by this tax expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer incentive credit is to lower the barrier of entry for a beginning farmer and make them more financially competitive.

Sources

The objective is described in [testimony](#) of HF608 by the bill’s author, Representative Nels Pierson, before the twenty-sixth meeting of the House Tax Committee during 2017-2018 session.

Other Considerations Regarding Proposed Tax Expenditure Objective

Nebraska enacted a [Beginning Farmer Tax Credit Act¹⁰](#) in 1999, preceding Minnesota's program. The intent of Nebraska's legislation is described in the enacting language and coincides with the proposed tax expenditure objective proposed in this review. In addition, evaluation studies published by the Iowa Department of Revenue in [2015¹¹](#) and [2020¹²](#) provided a comparable rationale for the objectives of a beginning farmer tax credit.

Potential Metrics and Performance Measures

Evaluations of similar tax credits include an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the demographics across different asset owners, asset types, and locations. The 2020 Iowa Department of Revenue evaluation of a similar tax expenditure compared outcomes of participants in the beginning farmer program to outcomes for beginning farmers who did not participate in the tax credit program. The Iowa study evaluated outcomes across three measures:

- Farm income
- Ratio of farm expenses to net income'
- Continued engagement in farming

Evaluations of the credit could also center around survey data of program participants to determine the level of which the landowner was influenced to sell or rent their land to a beginning farmer based on the financial incentive received from the tax credit.

Contact Information

This proposed tax expenditure objective review was prepared by the Legislative Budget Office for the Tax and Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

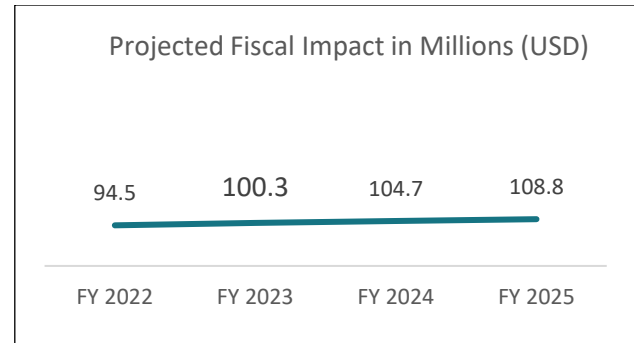
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Research and Development Credit

Proposed Tax Expenditure Objective Review - TEB 1.86, 2.27

Tax Expenditure Facts

Year Enacted	1981
Statute	Minn. Stat. Section 290.068
Tax Type	Corporate Franchise Tax Credit, Individual Income Tax Credit
Provision Type	Credit
Latest Fiscal Impact Estimate	\$56,359,827 -Tax Year 2019
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None



Tax Expenditure Description

Minnesota allows businesses conducting research and development within Minnesota to claim a nonrefundable credits against their corporate franchise taxes or individual income taxes (for pass-through tax entities, such as LLCs and S corporations). Expenditures include wages, costs of supplies, computer costs, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

The tax credit is based on the excess of current-year research expenditures over a calculated base amount, but in most cases 50% of current-year research expenditures are eligible for the credit. The credit is 10% of the first \$2 million of eligible expenditures and 4% of the excess over \$2 million. Any credit that exceeds liability can be carried forward up to fifteen years.

Additional Background Information

This tax expenditure is structured in line with the federal R&D credit in [Section 41 of the Internal Revenue Code¹³](#).

This tax expenditure is administered by the Department of Revenue. Beneficiaries of this tax expenditures are Individual taxpayers and Corporate. The state fund impacted by this tax expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of Research and Development Credit is to create or retain jobs, increase research activity, and attract or retain business in Minnesota

Sources

The Office of Legislative Auditor proposed the above statement as individual purposes in its 2017 [Minnesota Research Tax Credit Evaluation Report¹⁴](#). The report was part of an evaluation of economic development incentive programs required by Minnesota session law¹⁵.

Other Considerations Regarding the Proposed Tax Expenditure Objective

The proposed objective is in line with the policy intents offered by Congressional Research Services of US Congress in their 2022 report, [Federal Research Tax Credit: Current Law and Policy Issues¹⁶](#).

The Minnesota House Research Department states that the R&D credit serves an “economic development” purpose in its 2017 publishing, [Short Subjects: Minnesota Research and Development Tax Credit¹⁷](#).

The Federal R&D credit was enacted in 1981 and Minnesota was the first state to follow suit. The background of economic conditions during the early 1980’s linked the rationale of the R&D credit to the economic theory of the Cobb-Douglas production Model¹⁸. One implication of the model is that innovation is the engine for growth¹⁹. Numerous academic studies reviewed by the LBO imply the same sentiment. Therefore, another potential purpose for the tax credit is to support innovation across industries in Minnesota.

Potential Metrics and Performance Measures

A possible metric for this tax expenditure includes an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across organizations of varying sizes, and industry.

Another potential metric is a Benefit-to-Cost Ratio, a comparison of the total R&D spending attributable to the credit’s total revenue loss.

An effectiveness study can be conducted to examine whether a business entity is more likely to conduct R&D in Minnesota after taking the R&D credit into consideration.

Economic modelling can be applied to study the short term and long term economic and fiscal impacts of the tax credit.

Contact Information

This proposed tax expenditure objective review was prepared by the Legislative Budget Office for the Tax and Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

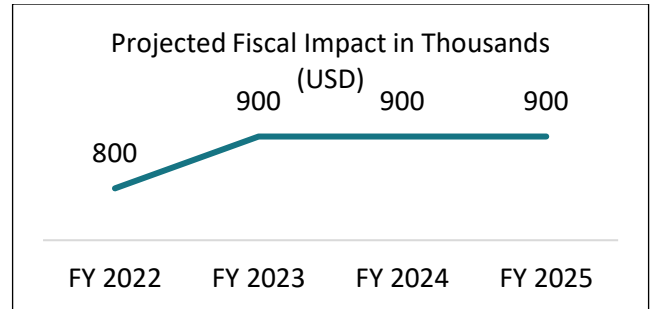
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Employer Transit Pass Credit

Tax Expenditure Initial Review - TEB 2.28

Tax Expenditure Facts

Statute	Minn. Stat. § 290.06, Subd. 28
Year Enacted	2000
Tax Type	Corporate Franchise Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	\$1,172,431 – Tax Year 2019
Latest Claims Estimate	Direct measure is not available
Expiration Date	None



Tax Expenditure Description

A nonrefundable credit is allowed against the corporate franchise tax equal to 30% of the expense incurred by the taxpayer to provide transit passes to the taxpayer's employees. The transit pass must be for use in Minnesota. If the employer purchases the transit passes from the transit system and resells them to the employees, the expenses used for the credit are the difference between the amount the employer paid for passes and the amount charged to employees.

Proposed Tax Expenditure Objective for Consideration

The objective of the Employer Transit Pass Credit is to incentivize Minnesota employers to subsidize transit passes for their employees to encourage the use of public transit.

Sources

The tax expenditure objective is based upon audio hearings for standalone companion bills pertaining to the Employer Transit Pass Credit for HF723²⁰ and SF813²¹ from the 1999 session.

Other Considerations Regarding the Proposed Tax Expenditure Objective

Several policy objectives were discussed in testimony or were identified through other sources beyond that stated in the tax expenditure objective. During testimony, it was mentioned that by incentivizing employers to provide transit passes to employees, that could help alleviate traffic congestion, reduce the need for or reduce the wear-and-tear on highways and roadways, and address parking scarcity issues in densely populated urban areas.

Additionally, it was mentioned that such a tax credit would help connect employers to a broader talent pool of employees, particularly those who desire more economical transportation and parking options.

At the federal level, Executive Order 13150, mandated that all Federal agencies in the National Capital Region implement a transportation subsidy program by October 1, 2000. The Internal Revenue Service's (IRS) Public Transportation Subsidy Program (PTSP) was established to encourage employees to use public transportation when commuting to and from work to improve air quality, reduce traffic congestion, and conserve energy by reducing the number of single occupancy vehicles on the road²².

The commission may want to consider these policy objectives in addition to or in place of the proposed tax expenditure objective stated above.

Potential Metrics and Performance Measures

Possible evaluations and measures of this tax credit could include a historical look at utilization trends of the tax credit as well as an analysis of public transportation routes designed to address user demand from employers utilizing the tax credit. Beyond that, survey data from businesses using the tax credit could provide insight into its usefulness and in evaluating its impact in expanding the available labor force or measure possible impacts on employee retention as a result of providing this transportation option for employees.

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax and Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

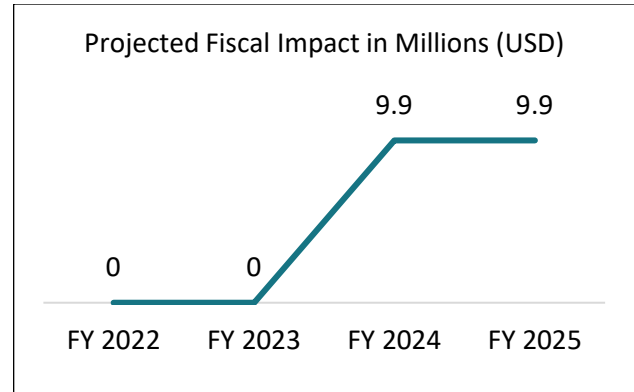
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Housing Contribution Credit

Tax Expenditure Initial Review - TEB 1.97, 2.32, 12.09

Tax Expenditure Facts

Year Enacted	2021
Statute	Minn. Stat. § 290.0683; 462A.40; 2971.20
Tax Type	Individual Income, Corporate Franchise, Insurance Premiums
Provision Type	Nonrefundable Credit
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	December 31, 2028



Tax Expenditure Description

A nonrefundable credit is allowed for contributions to a designated account in the Housing Development Fund administered by the [Minnesota Housing Finance Agency \(MHFA\)](#). The account is to be used for grants and loans for low and moderate-income housing developments.

The credit is equal to 85% of contributions of at least \$1,000 but not more than \$2 million. Any unused credit may be carried over for up to 10 years. Total credits are limited to \$9.9 million in each year. The credit was enacted in 2021 and is effective for tax years 2023 through 2028.

Note: The estimates shown on the graph are the total projected credits to be claimed against the corporate franchise tax, the individual income tax, and the insurance premiums tax.

Additional Background Information

An individual or business that contributes to the Minnesota Housing Tax Credit Contribution Account can reduce their income, franchise, or insurance premium tax liability by up to 85 percent of the contribution amount. The taxpayer may indicate that a contribution is intended for a specific [qualified](#) project.²³

This expenditure reduces the amount of income tax that is collected. Income tax revenue is deposited in the state General Fund as provided by [Minn. Stat. 290.62](#).

MS 462A.40, subd. 5 requires the MHFA to submit a report by January 15 of each year on the tax credits and financing provided in the previous fiscal year.

Proposed Tax Expenditure Objective for Consideration

The objective of the Minnesota Housing Tax Credit (Minn. Stat. 290.0683) is to increase the development and availability of affordable housing to persons and families of low and moderate incomes in Minnesota.

Sources

This statement was taken from companion bills [SF1866](#) and [HF1971](#), as introduced (2021). Bill sections one through three are functionally identical to the language that was ultimately enacted in Laws 2021 and codified

in statute. Section four of SF1866 / HF1971 includes the statement shown above and indicates that the statement is intended to fulfill the requirements of [MS 3.192](#) (Requirements for New or Renewed Tax Expenditures). Although there are some technical differences between SF1866 / HF1971 and statute such as contribution thresholds, the credit is structured the same.

In addition, bill authors emphasized at Tax Committee hearings for SF1866 and HF1971 that the proposed legislation was intended to address a shortage of affordable housing in Minnesota.²⁴

Other Considerations Regarding Proposed Tax Expenditure Objective

- Bills introduced in 2019 (HF1156/SF404) and 2018 (HF4072/SF3301) contain language similar to SF1866 and current statute, including objectives that are identical to the statement shown above.
- Bill author testimony for SF1866 and HF1971 indicates that bill language was modeled after the North Dakota Housing Incentive Fund Tax Credit. This incentive was created in 2011 to help address an affordable housing shortage in western North Dakota.
- This credit was enacted in [Laws 2021, First Special Session](#). A statement of intent was not included in Laws 2021 or the corresponding omnibus bill.²⁵
- Other states that offer housing tax credits generally do so in order to encourage the development of affordable housing. For example, the stated purpose of the recently passed [Kansas Housing Investor Tax Credit Act](#) is to “bring housing investment dollars to communities lacking adequate housing”.²⁶

Potential Metrics and Performance Measures

MS 462A.40, subd. 5 requires the MHFA to provide a report by January 15 of each year that includes “a breakdown of the tax credits, grants, and loans by region of the state. The report shall also include information on planned financing in the current fiscal year.” Staff anticipate using MHFA report data along with other state/federal data to compare the historical rate of affordable housing development in Minnesota with the rate of development after the tax credit has been effective for three or more years, particularly the development of housing units that meet the criteria specified in [MS 462A.40, subd. 2](#). A performance review could also compare geographical housing needs with the locations of tax credit supported development, depending on the availability of demographic and survey data – is the credit improving the allocation of affordable housing?

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

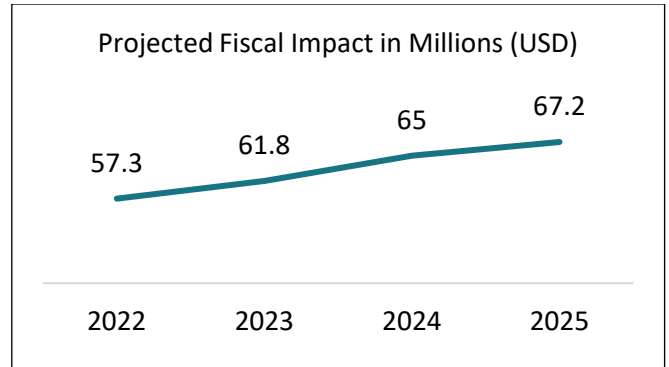
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Telecommunications Equipment

Tax Expenditure Initial Review - TEB 4.21

Tax Expenditure Facts

Year Enacted	2001
Statute	MS Section 297A.68, subd. 35a
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	None



Tax Expenditure Description

An exemption from the sales and use tax is allowed for telecommunications, cable television, and direct satellite equipment purchased or leased for use directly by a telecommunications, cable television, or direct satellite service provider in providing telecommunications services that are ultimately sold at retail. The exemption applies regardless of whether purchases are made by the owner, a contractor, or a subcontractor.

The exemption includes machinery, equipment, and fixtures used in receiving, initiating, amplifying, processing, transmitting, retransmitting, recording, switching, or monitoring telecommunications services. It also includes repair and replacement parts and accessories for qualifying equipment. The exemption does not include wire, cable, or poles.

This exemption was enacted in 2001. In 2013, the exemption was repealed, effective July 1, 2013. In 2014, the exemption was reinstated, effective April 1, 2014. The exemption was expanded to include fiber and conduit in 2017.

Additional Background Information

This tax expenditure provides a specific economic benefit to telecommunications and pay television service providers.

An internet service provider does not provide telecommunications or pay television service as defined in [MS 297A.61, subd. 24-25](#) and therefore cannot purchase equipment exempt from the sales tax. When machinery and equipment is purchased that can be used in providing internet service as well as telecommunications and pay television services, the exemption applies only if the taxpayer can document that the machinery and equipment will be used principally in the providing of telecommunications or pay television services.²⁷

The Minnesota Department of Revenue administers the sales and use tax. A purchaser must provide a completed certificate of exemption to the seller in order to claim the exemption.

This tax expenditure reduces the amount of sales tax that is collected. Sales tax revenue is deposited in the state General Fund except as provided by [MS 297A.94](#).

Proposed Tax Expenditure Objectives for Consideration

The tax expenditure objective of the Telecommunications Equipment Exemption (MS 297A.68, subd. 35a) is to reduce potential tax pyramiding and promote transparency in the tax system by exempting telecommunications equipment that is used to provide taxable telecommunications services.

The tax expenditure objective of the 2017 amendment to the Telecommunications Equipment Exemption (MS297A.68, subd. 35a) that expanded the definition of “telecommunications or pay television machinery and equipment” to include fiber and conduit is to increase the deployment and accessibility of broadband internet service in Minnesota.

Sources

The tax expenditure objective statement for the general exemption is based on testimony from House and Senate Tax Committee hearings for companion bills HF2023 and SF1819, which were ultimately included in the 2001 tax omnibus bill HF1.²⁸

The proposed tax expenditure objective statement for the 2017 amendment is based on author testimony from House and Senate Tax Committee hearings for companion bills SF955 and HF1250, which were ultimately included in the 2017 omnibus tax bill HF1.²⁹

Other Considerations Regarding the Proposed Tax Expenditure Objective

The legislature created a working group in 1997 to study the taxation of telecommunications services. The final report published in 1999 provided eight recommendations, including a sales tax exemption for telecommunication equipment used in providing taxable telecommunication services. The report contended that an exemption would (a) reduce potential tax pyramiding, (b) better align the Minnesota sales tax with the economic definition of a consumption tax, and (c) “send a welcoming message to telecommunication firms looking to locate in this state”.³⁰

Potential Metrics and Performance Measures

Staff anticipate that a qualitative assessment will be needed to determine if the tax expenditure is meeting its objective. This type of analysis may include an overview of consumption tax policy principles, the differences between a sales tax and gross receipts tax, the effects of potential tax pyramiding (such as changes in market behavior, embedded taxes, and cross-border effects), and the extent to which this expenditure helps align statutory sales tax rates with effective sales tax rates, if measurable.

An administrative and technical review may also be necessary based on the stated objective of the 2017 amendment referenced above. If the intent of the amendment was to expand broadband internet access, then the expenditure may need to be clarified to ensure that the exemption of fiber and conduit applies to internet service providers as well as telecommunications and pay television providers. Note that companion bills [SF3480](#) and [HF4422](#) introduced during the 2022 session proposed to specifically exempt fiber and conduit purchases made by a broadband or internet service provider, but the bill was not enacted.

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

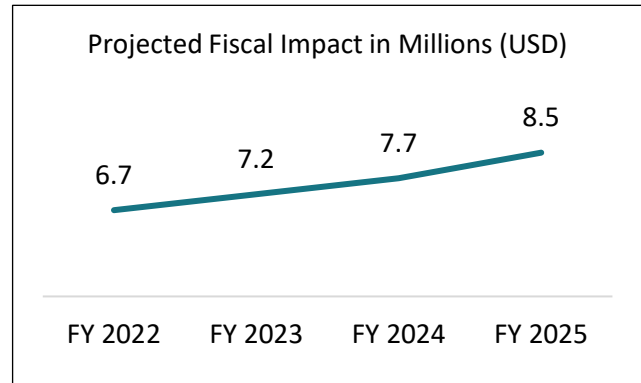
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>

Solar Energy Systems

Tax Expenditure Initial Review - TEB 4.27

Tax Expenditure Facts

Year Enacted	2005
Statute	Minn. Stat. § 297A.67, subd. 29
Tax Type	General Sales and Use Tax
Provision Type	Exemption - Particular Goods and Services
Latest Fiscal Impact Estimate	Direct measure of this estimate not available
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None



Tax Expenditure Description

Solar energy systems are exempt from the sales and use tax. A solar energy system is a set of devices whose primary purpose is to collect solar energy and convert and store it for useful purposes including heating and cooling buildings or other energy-using processes, or to produce generated power by means of collecting, transferring, or converting solar-generated energy.

Additional Background Information

Individual components of a solar energy system are covered under this expenditure. A solar energy system generally includes solar thermal electric and solar photovoltaic technologies. A similar sales tax exemption for photovoltaic devices was enacted in 2001 and expired in 2005³¹.

Beneficiaries of the current tax exemption include all taxpayers who purchase a solar energy system. This exemption is administered by the Department of Revenue. The impacted state fund is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the solar energy systems general sales and use tax exemption is to incentivize and promote the implementation and utilization of solar energy systems in the state of Minnesota to achieve a greater percentage of renewable energy contributions to the state's electricity fuel generation mix.

Sources

An explicit tax expenditure objective was not identified in the legislative record.

The goals and benchmarks under Minnesota statute 216B.1691 for renewable energy standards were considered to develop an objective for this tax expenditure. Per MS 216B.1691, subd. 2f, by 2020 at least 1.5 percent of retail electric sales to retail customers must be generated by solar energy. The statute establishes a goal that by 2030, 10 percent of retail electric sales must be generated by solar energy. The use of tax incentives is one of several state efforts to promote renewable energies. Other efforts focus on increasing supply, supporting demand, funding the development of supporting infrastructure, and funding research.

Minnesota's legislative efforts in these areas are further summarized by the Minnesota House Research Department's 2005 Short Subjects brief, [Minnesota Statutes, section Promoting Renewable Sources of Electricity](#).³²

Nineteen separate states and U.S. territories have implemented a sales tax exemption to promote the use of solar energy across residential use, commercial use, and utility providers.³³ This includes the states bordering Minnesota. At the federal level, a nonrefundable tax credit is available for homeowners that install certain energy efficient technologies.

Potential Metrics and Performance Measures

An analysis of the program's participation by submission of exemption certificates may identify trends in uptake of the tax incentive³⁴.

A review of the state's solar capacity over time categorized by sector contribution (residential, commercial, community, and utility) may identify increases in implementation of solar energy systems. An analysis of the geographical distribution of solar energy systems throughout the state may indicate variance in the utilization of solar energy systems by region.

A review of solar energy projects permitted by the Minnesota Department of Commerce may provide further insights into trends in solar energy implementation and utilization.

A comprehensive report to analyze the state's solar potential was prepared for the Department of Commerce and The Minnesota Solar Pathways Project in 2018³⁵. This report may be referenced to consider alternatives to assess the state's solar potential and the relationship to the solar energy systems tax exemption.

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

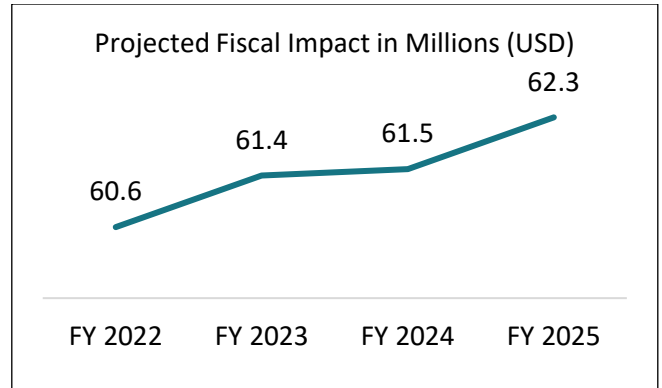
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>

Farm Machinery Exemption

Tax Expenditure Initial Review - TEB 4.39

Tax Expenditure Facts

Year Enacted	1981
Statute	Minn. Stat. § 297A.69, subd. 4(1), and 297A.61, subd. 12
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	None



Tax Expenditure Description

All farm machinery is exempt from the Minnesota sales and use tax. Qualifying farm machinery includes machinery, equipment, implements, and accessories used directly and principally in the production for sale of agricultural products, including livestock. Irrigation systems also qualify for exemption.

A reduced rate for farm machinery was first enacted in 1981 at 4% when the general rate was 5%. In 1985, the rate was reduced to 2%, and in 1991 it was increased to 2.5% when the general rate was increased by 0.5%. Used farm machinery was exempted in 1994 as a temporary provision, and the exemption was made permanent in 1997. In 1998, the rate on new equipment was phased out over two years, with the full exemption effective on July 1, 2000. The definition of farm machinery eligible for exemption has been expanded several times and was last modified in 2006.

Additional Background Information

This tax expenditure provides a specific economic benefit to agricultural producers who purchase qualifying farm machinery.

The Minnesota Department of Revenue administers the sales and use tax. A purchaser must provide a completed certificate of exemption to the seller in order to claim the exemption.

This tax expenditure reduces the amount of sales tax that is collected. Sales tax revenue is deposited in the state General Fund except as provided by [MS 297A.94](#).

Proposed Tax Expenditure Objective for Consideration

The objective of the farm machinery exemption is to reduce potential tax pyramiding and promote transparency in the tax system by exempting machinery and equipment used directly in the agricultural production of tangible personal property ultimately intended to be sold at retail.³⁶

Sources

The tax expenditure objective for consideration is informed by a review of statute language including MS 297A.69 and 297A.61. Statute, originating bills, committee hearings, and available legislative documentation

do not directly state a purpose for the farm machinery exemption. Staff did not find an adopted objective statement in review of similar exemptions in other states.

Other Considerations Regarding Proposed Tax Expenditure Objective

Farm machinery, replacement parts, fertilizer, and other agricultural items are commonly exempted from sales tax in other states; a recent Colorado review identified 38 states that have total or partial exemptions for farm equipment.³⁷ The definition of agricultural “machinery” or “equipment” varies from state-to-state, but generally the item must be used directly and principally in producing tangible personal property intended for retail sale in order to qualify, similar to the Minnesota exemption. Items that are not directly used in the production process are generally taxable, suggesting that most states offer these types of exemptions primarily to reduce tax pyramiding and increase transparency.

The commission may also want to consider if a primary or secondary objective of this expenditure is to provide a specific economic benefit to agricultural producers, for instance to support farming operations generally or to help small farmers replace worn-out equipment.

Potential Metrics and Performance Measures

Staff anticipate that a qualitative assessment will be needed to determine if the tax expenditure is meeting its objective. This type of analysis may include an overview of consumption tax policy principles, the differences between a sales tax and gross receipts tax, the effects of tax pyramiding (such as changes in market behavior, embedded taxes, and cross-border effects), and the extent to which this expenditure helps align statutory sales tax rates with effective sales tax rates, if measurable.

Stakeholder surveys and Department of Revenue data may help inform a cost-benefit analysis. For example, survey responses to a Colorado review of farm equipment exemptions indicated that agricultural producers found the exemption “impactful for purchases of more expensive equipment, such as tractors and combines,” which was balanced against forgone state and local sales tax revenue.³⁸

Contact Information

This tax expenditure statement review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Building Materials for Residences of Disabled Veterans

Tax Expenditure Initial Review - TEB 4.54

Tax Expenditure Facts

Year Enacted	1971
Statute	Minn. Stat. § 297A.71, subd. 11
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Direct measure of this estimate not available
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None

Estimated fiscal impact is less than \$50,000 per year through fiscal year 2025.

Tax Expenditure Description

Building materials used to construct or remodel the residence of a disabled veteran are exempt from the sales and use tax. The exemption applies if the project is financed in whole or in part by the U.S. Government in accordance with [United States Code, Title 38, Sections 2101 to 2105](#).

Additional Background Information

United States Code, Title 38, Sections 2101 to 2105 are administered as [Specially Adapted Housing](#) (SAH) grants and [Special Home Adaptation](#) (SHA) grants by the United States Department of Veteran's Affairs. The Minnesota Department of Revenue administers the sales tax exemption on a refund basis.³⁹

Veterans with qualifying service-connected disabilities who are awarded SAH/SHA grant money to construct or modify their permanent home are eligible for the state sales tax exemption.⁴⁰ SAH and SHA grants are not subject to federal or state income taxes.⁴¹

This tax expenditure reduces sales tax revenues. Sales tax revenue is deposited in the state General Fund except as provided by [MS 297A.94](#).

Proposed Tax Expenditure Objective for Consideration

The objective of the building materials exemption for residences of disabled veterans (Minn. Stat. 297A.71, subd. 11) is to provide specific sales and use tax relief to disabled veterans who have been awarded a federal grant for the construction or remodeling of their homes, ensuring that disabled veterans receive the full financial benefit of the federal program.

Sources

This statement was adapted from Washington State statute⁴². Washington offers a similar tax expenditure that includes legislative findings and a statement of intent section written into statute.

Other Considerations Regarding Proposed Tax Expenditure Objective

Enacting legislation [Laws 1971 Regular Session](#) does not include a statement of purpose. This expenditure has not been significantly modified since initial enactment.⁴³

A statement of purpose was not found in applicable committee meeting minutes. Audio or other media from this time is not available.

The Veteran's Homestead Exclusion (TEB # 13.02), which also provides tax relief for disabled veterans, includes a purpose statement in statute. "The purpose of this provision of law providing a level of homestead property tax relief for veterans with a disability, their primary family caregivers, and their surviving spouses is to help ease the burdens of war for those among our state's citizens who bear those burdens most heavily."⁴⁴

Potential Metrics and Performance Measures

Comparing the annual number or amount of refunds issued by the Minnesota Department of Revenue for qualified building material costs with the number or amount of adapted housing grants awarded by the United States Department of Veteran's Affairs to Minnesota veterans may help identify the extent to which the tax exemption is being utilized in conjunction with federal grants.

A survey among eligible population may also indicate public awareness of the tax benefit and likelihood of utilization.

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

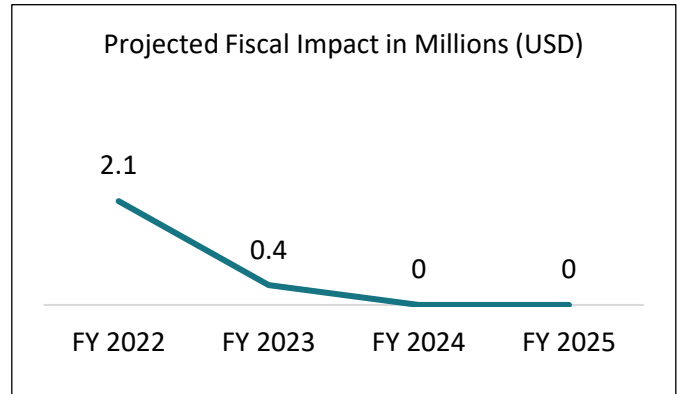
For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>.

Construction Materials for Certain City Projects

Tax Expenditure Initial Review - TEB 4.73

Tax Expenditure Facts

Year Enacted	2012
Statute	Minn. Stat. § 297A.71, subd. 44 and 297A.9905
Tax Type	General Sales and Use Tax
Provision Type	Exemption – Sales to Particular Purchasers
Latest Fiscal Impact Estimate	Direct measure of this estimate not available
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None



Tax Expenditure Description

Materials and supplies used or consumed in, and equipment incorporated into, the construction or improvement of a capital project of regional significance funded partially or wholly by a city of the first class are exempt. To qualify for this exemption, the project must be the construction, expansion, or renovation of a sports facility or convention or civic center and have a total construction cost of at least \$40 million within a 24-month period. Funding must be drawn from the excess revenues generated by imposition of a local tax on retail sales.

Additional Background Information

Contractors engaged in eligible capital projects are direct beneficiaries of this exemption. Local municipalities are indirect beneficiaries of this exemption, assuming that qualifying sales tax exemptions are considered into lower construction bid entries for eligible projects. A reduction in sales and use tax receipts impacts the state's General Fund. The collection of sales and use tax is administered by the Department of Revenue.

Proposed Tax Expenditure Objective for Consideration

The objective of the sales tax exemption for construction materials for certain city projects is to provide an indirect means of assistance to local governments for capital projects funded wholly or partly by excess local tax revenues imposed under special law.

Sources

An explicit tax expenditure objective was not identified in the legislative record. However, an author's description to this exemption in 2017 describes the sales tax exemption as a means to help fund a city project⁴⁵. Additionally, the state of Pennsylvania adopted a similar objective statement for a sales tax exemption on machinery and construction equipment used in a construction contract with a governmental unit including political subdivisions⁴⁶.

Other Considerations Regarding Proposed Tax Expenditure Objective

In 2017, MS § 297A.71 subd. 44 was amended to provide a sales tax exemption on construction materials, supplies, and equipment to the city of Plymouth to help fund capital improvements to the Plymouth Ice Center. During testimony before the House Tax Committee, the author of the original amendment, describes the amendment as a means of helping the city fund repairs in order to meet federal requirements for refrigerant coolants and energy systems. This language was adopted into the 2017 omnibus tax bill, where the sales tax exemption was extended to the construction of a stadium located on land which is now Allianz field in St. Paul⁴⁷.

In 2012, this exemption was included in the legislation that included the construction of the U.S. Bank Stadium. Discussion in committee hearings on that specific bill references similar tax policy applying to the development of Target Field⁴⁸.

In 2021, the Office of the State Auditor of Colorado evaluated a similar sales tax exemption which applies more generally to contractors and subcontractors performing construction services for certain tax-exempt entities. A potential objective offered for consideration was “to avoid applying sales and use taxes to contractors’ purchases of construction and building materials when completing projects for tax-exempt entities.”⁴⁹

An analysis of this expenditure should also consider a broader policy objective of attracting and stimulating economic benefits towards the geographic region where such capital projects are pursued.

Potential Metrics and Performance Measures

The following are approaches taken by other state or district offices to evaluate the effectiveness or impact of a sales tax exemption on construction and building materials.

The Office of the State Auditor of Colorado identifies a challenge in evaluating a tax incentive if a quantifiable goal is not stated by the general assembly. Thus, the office relies on a survey of eligible contractors and subcontractors that would presumably file for the tax exemption to assess likelihood of participation and awareness by eligible beneficiaries.

Connecticut’s Department of Economic and Community Development reports information limited to the total amount of sales tax revenue forgone for a variety of capital projects approved on the state’s behalf⁵⁰.

Washington D.C. enacted a sales tax exemption on construction materials to increase the construction and availability of supermarkets within specific wards⁵¹. The district intended to achieve positive externalities of increased access to nutritious foods leading to positive health outcomes for residents of those wards. A report by the district’s office of Revenue Analysis indicates the sum of claims associated with the exemptions and an analysis on the construction of supermarkets in targeted areas of the district. Similar metrics of direct outcomes are repeatable in Minnesota for construction projects. The report identifies challenges in measuring externalities intended by the program.

Contact Information

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statutes, section 3.8855](#).

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

For information on the Tax Expenditure Review Commission, please visit <https://www.lbo.mn.gov/TERC/index.html>

This page is left intentionally blank.



Tax Expenditure Initial Review References

¹ Minnesota Statutes 2021, section 290.06 subdivision 2c(e)

² Dalton, P, Manzi, N and J, Michael. (2013). *A Review of Selected Tax Expenditures*. St. Paul: Research Department of the Minnesota House of Representatives

³ Manzi, N and J, Michael. (2016). *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*. St. Paul: Research Department of the Minnesota House of Representatives

⁴ (2022). *The Working Family Credit and Federal Earned Income Credit*. St. Paul: Research Department of the Minnesota House of Representatives

⁵ Minn. House. Hearing on H.F. 516 before the House Tax Committee on Taxes, 90th Minn. Leg., Reg. Sess. (Feb. 19, 2017), available at: <https://www.house.leg.state.mn.us/hjvid/90/889769> (video)

⁶ Yarmuth, J (2018). *The Earned Income Tax Credit Boosts Work, Reduces Poverty, and Provides Other Benefits for Working Americans*. Washington DC: Committee on the Budget of U.S. House of Representatives

⁷ Mishra, A., Wilson, C., & Williams, R (2009). Factors affecting financial performance of new and beginning farmers. *Agricultural Finance Review*, Vol. 69 pages 160-179

⁸ Katchova, A.L. and R. Dinterman. (2018). Evaluating Financial Stress and Performance of Beginning Farmers during the Agricultural Downturn. *Agricultural Finance Review*, Vol.78

⁹ Office of the Legislative Auditor (2018) *The Beginning Farmer Tax Credit Act: Performance on Selected Metrics*. Lincoln. Performance Audit Committee – Nebraska Legislature.

¹⁰ (1999) State of Nebraska Legislative Bill 630

¹¹ Girardi, A. (2015). *Beginning Farmer Tax Credit Program Tax Credit Program Evaluation Study*. State of Iowa: Tax Research and Program Analysis Section Iowa Department of Revenue.

¹² Montgomery, E. (2020). *Beginning Farmer Tax Credit Program Tax Credits Program Evaluation Study*. State of Iowa: Tax Research and Program Analysis Section Iowa Department of Revenue.

¹³ 26 U.S.C. § 41

¹⁴ Office of the Legislative Auditor. (2017). *Minnesota Research Tax Credit*. St. Paul: State of Minnesota

¹⁵ Laws of Minnesota 2015, chapter 77, article 2, section 1, subdivision 2.

¹⁶ Guenther, G. (2022). *Federal Research Tax Credit: Current Law and Policy Issues*. Washington D.C.: Congressional Research Service.

¹⁷ Michael, J. (2017). *Short Subjects: Minnesota Research and Development Tax Credit*. St. Paul: Research Department of the Minnesota House of Representatives

¹⁸ Aghion, Durlauf, Aghion, Philippe, Durlauf, Steven N, & ScienceDirect. (2005). *Handbook of economic growth. Volume 1B* (1st ed., Handbooks in economics bk. 22). Amsterdam: Elsevier.

¹⁹ Verba, M. (2019). *Growth and Innovation in the presence of Knowledge and R&D accumulation Dynamics*. Economics of Innovation and New Technology

²⁰ Minn. H., Hearing on H.F. 723 before the H. Comm. on Taxes, 81st Minn. Leg., Reg. Sess. (Mar. 23, 1999), available at <https://www.lrl.mn.gov/media/file?mtqid=811061>

²¹ Minn. Sen., Hearing on S.F. 813 before the Sen. Comm. on Taxes, 81st Minn. Leg., Reg. Sess. (Mar. 29, 1999), available at: <https://www.lrl.mn.gov/media/file?mtqid=811202>

²² Treasury Inspector General for Tax Administration. (2008). Review of the Internal Revenue Service's Public Transportation Subsidy Program. Washington D.C.: Department of the Treasury. Available at <https://www.treasury.gov/tigta/auditreports/2018reports/201810033fr.pdf>

²³ MS 462A.40, subd. 2-3 define what funds deposited in the Minnesota Housing Tax Credit Contribution Account can be used for.
<https://www.revisor.mn.gov/statutes/cite/462A.40#stat.462A.40.2>.

²⁴ Senate Tax Committee hearing, March 23, 2021. SF1866 is discussed at 21:50 of the audio, available at www.senate.mn or the following [direct link](#). House Tax Committee hearing, March 25, 2021. HF1971 is discussed at 1:15 of the audio, available at www.house.leg.state.mn.us or the following [direct link](#).

²⁵ See Minnesota Laws 2021, First Special Session chapter 14, article 1, sections 13, 15, and 16.

²⁶ Summary of Kansas HB 2237, available online at http://www.kslegislature.org/li/b2021_22/measures/documents/summary_hb_2237_2022.

²⁷ See Revenue Notice #2-14 available at the Minnesota Department of Revenue website, <https://www.revenue.state.mn.us/revenue-notice/02-14-sales-and-use-tax-exemption-purchases-telecommunications-equipment-internet>.

²⁸ House Sales and Income Tax Division hearing (March 29, 2001). Audio recording available at <https://www.lrl.mn.gov/media/file?mtqid=821004>; Senate Income and Sales Tax Budget Division hearing (April 4, 2001). Audio recording available at <https://www.lrl.mn.gov/media/file?mtqid=821052>.

²⁹ Senate Tax Committee Hearing (February 23, 2017). SF 955 is discussed at 1:40 of the audio recording, available online at https://mnsenate.granicus.com/player/clip/1339?view_id=2&redirect=true&h=07b2ceec9c0962b8b3bf8b10604fc812; House Tax Committee Hearing (February 23, 2017). HF1250 is discussed at 43:23 of the audio recording, available online at <https://www.house.leg.state.mn.us/Committees/minutes/90023/56877>.

³⁰ Report of the Working Group on Taxation of Telecommunication Services (February 18, 1999). Available at the Minnesota Reference Library, <https://www.lrl.mn.gov/>.

³¹ Laws of Minnesota 2001, chapter 5, article 12, section 44

³² Elef, B. (2005, December). Minnesota Statutes Renewable Sources of Electricity. St. Paul: Research Department of the Minnesota House of Representatives.

³³ Programs. (2022, September). Retrieved from Database of State Incentives for Renewable and Efficiency (DSIRE): <https://programs.dsireusa.org/system/program>

³⁴ Minnesota Department of Revenue. (2019, July). Form ST3, Certificate of Exemption.

³⁵ Putnam, M; Perez, M. (2018). Solar Potential Analysis Report. Napa: Clean Power Research.

³⁶ Tax pyramiding refers to the imposition of a sales tax at one or more stages of production and distribution before the final (retail) sale to consumers.

³⁷Office of the State Auditor. (2022). Farm Equipment and Parts Exemption Evaluation Summary. Denver: State of Colorado. https://leg.colorado.gov/sites/default/files/te5_farm_equipment_parts_exemption.pdf

³⁸ Ibid.

³⁹ Minnesota Rules 8130.6600 outlines the refund procedure for this exemption. <https://www.revisor.mn.gov/rules/pdf/8130.6600/2022-06-09%2009:08:07+00:00>

⁴⁰ Detailed program requirements can be found online at <https://www.va.gov/housing-assistance/disability-housing-grants/> and https://www.benefits.va.gov/HOMELOANS/documents/docs/sah_handbook_for_design.pdf.

⁴¹ See Minnesota's 2022 Tax Expenditure Budget item 1.18 for more information.

⁴² See Revised Code of Washington [title 82, chapter 08 section 0207](#)

⁴³ Minnesota Laws 1971, chapter 124. Available online at <https://www.revisor.mn.gov/laws/1971/0/Session+Law/Chapter/124/pdf/>.

⁴⁴ Minnesota Statutes 2021, section 273.13 subdivision 34(l)

⁴⁵ Minn. House, Hearing on HF924 before the House Committee on Taxes, 90th Minn. Leg. Reg. Sess. (Mar. 3, 2017), available at: <https://www.house.leg.state.mn.us/hjvid/90/889866> (video)

⁴⁶ Office of the Governor. (2022). Executive Budget. Harrisburg: Commonwealth of Pennsylvania.

⁴⁷ Laws of Minnesota 2017, 1st Special Session, chapter 1, article 3, Section 30.

⁴⁸ Minn. Sen., Hearing on SF2391 before the Sen. Comm. on Taxes, 87th Minn. Leg., Reg. Sess. (Apr. 27, 2012), available at: <https://www.lrl.mn.gov/media/file?mtgid=870932> (video)

⁴⁹ Office of the State Auditor. (2021). Construction and Building Materials Exemption Evaluation Summary. Denver: State of Colorado

⁵⁰ Department of Economic and Community Development. (2019). Annual Report. New Haven: State of Connecticut

⁵¹ Office of Revenue Analysis. (2018). Review of Economic Development Tax Expenditures. Washington D.C. Government of District of Columbia.