2002-03 Minnesota Biennial Budget

Presented by Governor Jesse Ventura to the 82nd Legislature

accountable

affordable

responsive

STATE & LOCAL FINANCE

Taxes, Aids & Credits

STATE & LOCAL FINANCE REFORM - CONTENTS

Price of Government Recommendations

For the 2002-03 biennium, the Governor recommends revenue targets of $34.1 billion, or 10.0% of state personal income, for state government and $20.5 billion, or 6.0% of state personal income, for local governments. For the 2004-05 biennium, the Governor recommends targets of $38.3 billion, or 10% of state personal income, for state government and $21.5 billion, or 5.6% of state personal income for local governments. These targets reflect the Governor's entire budget proposal.

Governor's 2001 Price of Government Recommendation
($ in Millions)

STATE	FY 2002	FY 2003	2002-03 Biennium	FY 2004	FY 2005	2004-05 Biennium
State Tax Revenues	13,482.7	15,468.0	28,950.7	16,147.9	16,858.4	33,006.3
as a percent of personal income	8.1%	8.8%	8.5%	8.7%	8.6%	8.6%
State Non-Tax Revenues	2,623.2	2,609.9	5,233.1	2,683.1	2,648.9	5,332.0
as a percent of personal income	1.6%	1.5%	1.5%	1.4%	1.3%	1.4%
Subtotal -- State Revenues	16,105.9	18,077.9	**34,183.9**	18,831.0	19,507.2	**38,338.2**
as a percent of personal income	9.7%	10.3%	**10.0%**	10.1%	9.9%	**10.0%**

LOCAL	FY 2002	FY 2003	2002-03 Biennium	FY 2004	FY 2005	2004-05 Biennium
Local Tax Revenues	5,379.3	4,426.6	9,805.9	4,722.9	5,039.6	9,762.5
as a percent of personal income	3.3%	2.5%	2.9%	2.5%	2.6%	2.6%
Local Non-Tax Revenues	5,220.0	5,460.9	10,680.9	5,718.9	6,001.7	11,720.6
as a percent of personal income	3.2%	3.1%	3.1%	3.1%	3.1%	3.1%
Subtotal -- Local Revenues	10,599.3	9,887.5	**20,486.8**	10,441.8	11,041.4	**21,483.2**
as a percent of personal income	6.4%	5.6%	**6.0%**	5.6%	5.6%	**5.6%**

TOTAL	FY 2002	FY 2003	2002-03 Biennium	FY 2004	FY 2005	2004-05 Biennium
Total Revenues	26,705.2	27,965.4	54,670.6	29,272.8	30,548.6	59,821.4
as a percent of personal income	16.1%	16.0%	16.1%	15.7%	15.6%	15.6%
State Personal Income	165,498.0	175,058.0	340,556.0	185,968.3	196,345.5	382,313.8
Total Revenues - Nov 00 Forecast	27,431.1	28,910.5	56,341.6	30,349.9	31,740.3	62,090.2
Change (Tax Savings)	**(725.9)**	**(945.1)**	**(1,671.0)**	**(1,077.1)**	**(1,191.7)**	**(2,268.8)**

The Price of Government Law

The M.S. 16A.102 contains provisions, commonly referred to as the "Price of Government" legislation, that require specific steps in the state's budget process.

- In November and February prior to the star of the biennium, the Departments of Finance and Revenue are required to project state and local taxes, other revenues and personal income for the current biennium and the two future biennia. This historical and projected data is to be presented by type of government and major revenue source.

- In January, the Governor is required to recommend revenue targets for the next two biennia that specify:
  - The maximum percentage of personal income to be collected in state and local taxes and other revenues;
  - the division of the share between state and local government revenues;
  - The approximate mix of rates of income, sales, and other state and local taxes and other revenues and the amount of local property taxes; and
  - The effect of the recommendation on the incidence of the tax burden by income class.

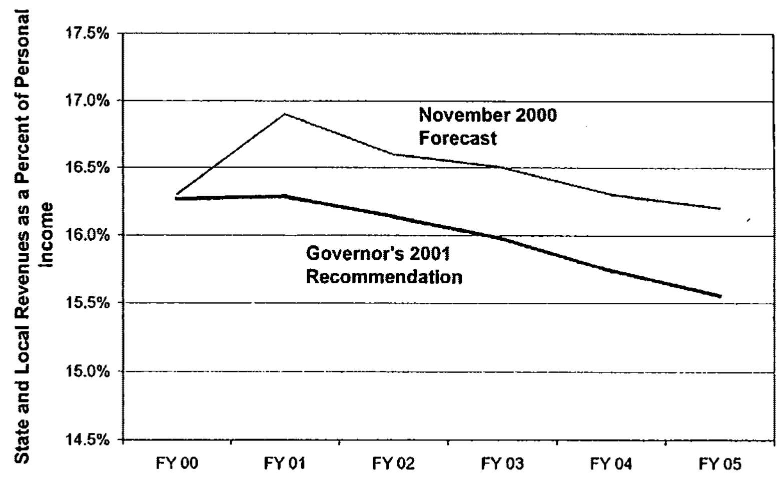
- By March 15th, the Legislature is required to adopt by concurrent resolution its own revenue targets for the same periods, including the same information as presented by the Governor. The Legislature's targets will be based on the February state and local revenue forecast prepared jointly by the Departments of Finance and Revenue.

These requirements ensure that the level of resources is established first, before decisions about spending are made. As a result, taxpayers are protected from tax and revenue increases driven by spending decisions.

November Forecast of State and Local Revenues

The starting point for the Governor's revenue target recommendation was the November 2000 forecast of state and local revenues. The forecast, prepared jointly by the Departments of Finance and Revenue, projected revenues based on current law, using current tax rates.

Governor's 2001 Price of Government Recommendation



The next step is aggregating the state and local revenue changes anticipated by the Governor's comprehensive budget recommendation. These impacts are then analyzed by tax type and governmental unit to come up with the final recommendation.

Governor's Price of Government Recommendation
By Government and Revenue Type ($ and % of Personal Income)
($ in Millions)

Fiscal Year	Unit	Taxes: Income		Sales		Property		Other Tax		Non-Tax Revenues		Total	
2000	State	5,556.4	3.8%	3,661.3	2.5%	-	0.0%	3,143.1	2.1%	2,045.7	1.4%	14,406.6	9.8%
	Local	-	0.0%	100.7	0.1%	4,617.3	3.1%	140.36	0.1%	4,657.1	3.2%	9,515.5	6.5%
	Total	5,556.4	3.8%	3,762.0	2.6%	4,617.3	3.1%	3,283.5	2.2%	6,702.9	4.6%	23,922.1	16.3%
2001	State	5,898.3	3.8%	3,575.7	2.3%	-	0.0%	3,050.5	2.0%	2,953.8	1.9%	15,478.3	9.9%
	Local	-	0.0%	105.9	0.1%	4,746.0	3.0%	145.33	0.1%	4,928.2	3.2%	9,925.6	6.4%
	Total	5,898.3	3.8%	3,681.7	2.4%	4,746.0	3.0%	3,195.8	2.0%	7,882.0	5.1%	25,403.9	16.3%
00-01	State	11,454.7	3.8%	7,237.0	2.4%	-	0.0%	6,193.6	2.0%	4,999.5	1.6%	29,884.9	9.9%
Biennium	Local	-	0.0%	206.6	0.1%	9,363.3	3.1%	285.7	0.1%	9,585.3	3.2%	19,441.1	6.4%
	Total	11,454.7	3.8%	7,443.7	2.5%	9,363.3	3.1%	6,479.3	2.1%	14,584.8	4.8%	49,326.0	16.3%
2002	State	5,763.9	3.5%	4,744.6	2.9%	-	0.0%	2,974.2	1.8%	2,623.2	1.6%	16,106.0	9.7%
	Local	-	0.0%	127.6	0.1%	5,100.8	3.1%	150.94	0.1%	5,220.0	3.2%	10,599.3	6.4%
	Total	5,763.9	3.5%	4,872.1	2.9%	5,100.8	3.1%	3,125.1	1.9%	7,843.2	4.7%	26,705.3	16.1%
2003	State	6,405.3	3.7%	5,525.3	3.2%	470.4	0.3%	3,067.0	1.8%	2,609.9	1.5%	18,077.9	10.3%
	Local	-	0.0%	138.6	0.1%	4,131.2	2.4%	156.83	0.1%	5,460.9	3.1%	9,887.5	5.6%
	Total	6,405.3	3.7%	5,663.8	3.2%	4,601.6	2.6%	3,223.8	1.8%	8,070.8	4.6%	27,965.5	16.0%
02-03	State	12,169.2	3.6%	10,269.8	3.0%	470.4	0.1%	6,041.2	1.8%	5,233.1	1.5%	34,183.9	10.0%
Biennium	Local	-	0.0%	266.1	0.1%	9,232.0	2.7%	307.8	0.1%	10,680.9	3.1%	20,486.8	6.0%
	Total	12,169.2	3.6%	10,536.0	3.1%	9,702.4	2.8%	6,348.9	1.9%	15,914.0	4.7%	54,670.7	16.1%
2004	State	6,682.1	3.6%	5,823.6	3.1%	484.5	0.3%	3,157.6	1.7%	2,683.1	1.4%	18,831.0	10.1%
	Local	-	0.0%	144.6	0.1%	4,415.3	2.4%	163.03	0.1%	5,718.9	3.1%	10,441.8	5.6%
	Total	6,682.1	3.6%	5,968.3	3.2%	4,899.8	2.6%	3,320.6	1.8%	8,402.0	4.5%	29,272.8	15.7%
2005	State	7,049.5	3.6%	6,115.9	3.1%	499.0	0.3%	3,193.8	1.6%	2,648.9	1.3%	19,507.3	9.9%
	Local	-	0.0%	151.9	0.1%	4,718.1	2.4%	169.55	0.1%	6,001.7	3.1%	11,041.4	5.6%
	Total	7,049.5	3.6%	6,267.8	3.2%	5,217.2	2.7%	3,363.4	1.7%	8,650.6	4.4%	30,548.6	15.6%
04-05	State	13,731.6	3.6%	11,939.5	3.1%	983.6	0.3%	6,351.5	1.7%	5,332.0	1.4%	38,338.2	10.0%
Biennium	Local	-	0.0%	296.6	0.1%	9,133.4	2.4%	332.6	0.1%	11,720.6	3.1%	21,483.2	5.6%
	Total	13,731.6	3.6%	12,236.1	3.2%	10,117.0	2.6%	6,684.0	1.7%	17,052.6	4.5%	59,821.4	15.6%

Governor Ventura's Tax Reform and Relief Proposals to the 2001 Legislature

The Governor's tax reform and relief proposals are the product of an 18 month effort to listen and talk with taxpayers, legislators, and local and state government officials across Minnesota about the state and local tax system. The focus of the discussions was on how the tax laws can be changed to better meet the needs of taxpayers, continue to support needed government services in a changing economy, and better align with the Governor's Big Plan strategic vision for the state.

In public dialogues, stakeholder meetings, focus groups, surveys, and interviews with state and local officials, concerns and hopes for changes in the tax laws focused on these general themes:

- Ensuring a fair distribution of tax burdens.
- Simplifying government budget and tax policies so taxpayers and public officials alike can better predict, understand and control them.
- Achieving and maintaining economic prosperity across Minnesota.

The Governor's recommendations reflect and respond to these concerns. The Governor's recommendations for tax reform and relief are comprehensive, incorporating changes to all major state and local taxes. The proposal has four overarching goals:

- Reduce the property tax and return it to local control by eliminating state-mandated impacts.
- Preserve the sales tax as source of revenue, and modernize it to fit a changing economy.
- Emphasize local government revenue flexibility and accountability to taxpayers.
- Improve the competitive position of Minnesota workers and firms in the increasingly global marketplace.

Focusing on the bottom line: Significant tax relief combined with fundamental tax reform

The Governor's recommendations reduce overall state and local taxes by over $1 billion annually in FY 2003, and reduce the reliance on both the property and income tax in the state and local revenue system. Within an overall reduced amount of state and local taxes and other revenues to be collected compared with current law, the proportion coming from property and income taxes will be reduced, and the share of total revenue contributed by the sales tax will increase. Under the Governor's recommendation, the sales tax will replace the property tax as the second-largest revenue source after the individual income tax, with an overall reduction in tax burden.

Fairness and balance among businesses and individuals, regions, and income levels

The key concern of Minnesota citizens and policymakers is for fairness and balance of tax burdens between business and individual taxpayers, between metro and Greater Minnesota communities, and across various levels of household income. The Governor's reform and relief recommendations have been developed with those concerns in mind. While a detailed analysis of tax incidence impacts in comparison to current law projections will not be available until March 2001, preliminary estimates indicate that the overall distribution of tax relief under the Governor's proposal will be consistent with the current distribution of tax burdens.

How will the plan affect individual taxpayers?

The Governor's tax reform and relief proposal makes a number of simultaneous changes in the tax laws – many of those offsetting the others within the entire tax system. As with the overall state and local revenue system, the bottom line effects on individual taxpayers reflect the sum total of these changes. Here are some representative examples of how Minnesota households will be affected by the recommendations:

What Selected Households Pay in State and Local Taxes and Impact of Governor's Proposals Tax Year 2003

	Married Filing Joint 2 Children Income about $60,000 Home Market Value $120,000			Married Filing Joint 2 Children Income about $100,000 Home Market Value $152,000			Married Filing Joint No Children Income about $250,000 Home Market Value $530,000		
Taxes	Current Law	Governor's Proposal	Change	Current Law	Governor's Proposal	Change	Current Law	Governor's Proposal	Change
Income	$2,237	$2,045	($192)	$4,606	$4,246	($360)	$15,088	$14,041	($1,047)
Sales	1,150	1,220	70	1,750	1,875	125	2,700	3,150	450
Property	1,506	1,286	(220)	2,128	1,724	(404)	10,164	9,080	(1,084)
M.V. Reg.	198	178	(20)	288	178	(110)	609	278	(331)
MNCare	174	113	(61)	251	163	(88)	284	185	(99)
Other	450	450	0	550	550	0	650	650	0
Total	$5,715	$5,292	($423)	$9,573	$8,736	($837)	$29,495	$27,384	($2,111)
Reduction			-7.4%			-8.7%			-7.2%

	Single Head of Household 2 Children Income low $30,000's Home Market Value $75,000			Single Income about $35,000 Home Market Value $80,000			Single Income about $75,000 Home Market Value $120,000		
Taxes	Current Law	Governor's Proposal	Change	Current Law	Governor's Proposal	Change	Current Law	Governor's Proposal	Change
Income	$708	$166	($542)	$1,540	$1,408	($132)	$3,908	$3,608	($300)
Sales	800	875	75	800	875	75	1,400	1,485	85
Property	780	664	(116)	840	729	(111)	1,506	1,286	(220)
M.V. Reg.	35	35	0	99	89	(10)	385	189	(196)
MNCare	119	77	(42)	52	34	(18)	87	57	(30)
Other	325	325	0	300	300	0	450	450	0
Total	$2,767	$2,142	($625)	$3,631	$3,435	($196)	$7,736	$7,075	($661)
Reduction			-22.6%			-5.4%			-8.5%

	Farm Family Income near $25,000 Home Market Value $30,000			Retired Couple Income about $30,000 Home Market Value $93,000		
Taxes	Current Law	Governor's Proposal	Change	Current Law	Governor's Proposal	Change
Income	($599)	($1,340)	($741)	$118	$107	($11)
Sales	700	765	65	750	820	70
Property	312	261	(51)	1,051	904	(147)
M.V. Reg.	198	178	(20)	99	89	(10)
MNCare	92	60	(32)	111	72	(39)
Other	300	300	0	325	325	0
Total	$1,003	$224	($779)	$2,454	$2,317	($137)
Reduction			-77.7%			-5.6%

Prepared by: Minnesota Department of Revenue, Tax Research Division, January 15, 2001

How will the plan affect business taxpayers?

The Governor's tax reform and relief proposal makes a number of significant changes to the way Minnesota taxes business with net relief of over $330 million per year. This is important, not only for Minnesota's competitive position in a changing economy, but also because business taxes ultimately affect individual workers and households.

Under current law, businesses pay about 33% of total state and local taxes, Minnesota households pay 64%, and nonresidents pay the remainder. (This is what's called "initial incidence," before business taxes are ultimately passed along to households through product prices, wages and benefits, or profits.)

Under the Governor's proposal, net tax relief to businesses and Minnesota households are estimated to be distributed in the same proportion as current taxes: 33% to businesses, and 64% to households.

How will the Governor's plan affect the regional distribution of tax relief?

Under current law, total state and local tax collections in the seven county metropolitan area are estimated to account for 66% of the statewide total. Under the Governor's proposal, the percentage of total state and local taxes paid in the metropolitan area is expected to remain at about the same level—roughly 66%. In the property tax component of the proposal, the relative tax relief in Greater Minnesota is larger than in the metropolitan area: under current law, property taxes in the 80 non-metro counties account for 35% of total property taxes statewide. Under the Governor's proposal, about 40% of the net property tax reduction occur in those same counties.

How will the Governor's plan affect the overall incidence of the tax system?

As indicated previously, a complete updated tax incidence analysis of current law will be available in March 2001. The Governor's recommendations have been designed to maintain the current roughly equal proportional distribution in overall tax burdens (direct and indirect) among households at various income levels. Reductions in both the income and property tax, continued sales tax exemptions for food, clothing, heating fuels, and other essential items, and increases in the state Working Family Credit and the maximum homeowner property tax refund are intended to maintain a balanced distribution of overall tax relief among Minnesota households.

Key policy recommendations in the Governor's tax reform proposal.

The Governor's key recommendations for reforming the tax system are:

- Provide an immediate "settle up" rebate as required by law.
- Reform K-12 education finance by fully funding the general education formula without reliance on a state-mandated property tax levy. This change will result in significant property tax relief combined with reform of the property tax classification system, and state aids systems;
- Modernize the sales tax to fit today's economy by imposing the sales tax equitably between goods and services, lowering the rate, and adopting other changes designed to improve collection of the sales tax in the face of the growing challenge of electronic commerce;
- Lower income tax rates and increasing the state Working Family Credit to continue recent progress in reducing Minnesota's nationally-high individual income tax burdens;
- Repeal taxes on HMO premiums and wholesale prescription drugs and stabilize the health care provider tax at a permanent rate of 1.5%. The Governor also recommends dedicating a share of existing cigarette excise tax receipts to health care purposes;
- Reduce motor vehicle registration (license tabs) taxes to continue progress toward the Governor's goal that no auto registration tax should exceed $75.

These proposals, and others included in the Governor's tax reform proposal, are each significant in their own right, but they become even more important as elements of comprehensive tax reform. Reform of the school financing structure provides property tax relief and makes the system more controllable and accountable to taxpayers. Property tax relief provides the opportunity to reform the classification and state aid systems. Reform of the sales tax both improves the fairness and long-term reliability of the sales tax as a viable revenue source, and provides opportunities for additional reductions in income, health care, motor vehicle and other taxes that would not be achievable otherwise.

School funding and property tax reform

The Governor's recommendations for property tax reform and relief are designed to make the property tax smaller, fairer, and a more local and accountable revenue source by eliminating state-mandated costs from the property tax. Under current law, the general education levy will add about $900 million to property tax bills in 2001. The single greatest direct, state-mandated spending driver in the local property tax is the general education levy, now used to fund a portion of the state-set, per-pupil general education formula. Removing this levy allows for meaningful class rate reform, because it is a major contributor to overall tax rate disparities between business and rental housing and other properties.

The Governor's recommendations for reforming the Property Tax system are:

- Eliminate the general education levy and funds the general education formula fully from state resources;
- Place responsibility for voter-approved additional school operating levies on residential (homeowner and apartment) or "voting" properties only, to promote greater local control and accountability over these spending and taxing decisions;
- Increase state equalization aid for operating referendum levies to allow voters in property-poor school districts to generate additional operating dollars with the same tax rates as voters in wealthier districts;
- Create a new statewide general fund (property tax) levy on business and seasonal properties or "non-voting" properties. The new statewide levy would provide that these properties contribute toward the state per pupil costs while still achieving net relief, and in exchange are exempted from local operating referendum levies;
- Exempt farmland (excluding the house, garage, and first acre) from both the local referendum levy and the statewide general fund levy;
- Maintain other remaining school property tax levies on the full local tax base (including businesses, seasonal properties, and farmland) and increase state debt service equalization aid.

The net effect of the Governor's recommendation is to increase the overall state share of school aids and levies from 69% under current law to 85% in FY 2003. The following chart illustrates the changes to state funding of education.

In combination with reform of the school finance reliance on the property tax, the Governor's recommendation also includes reforms of the property tax classification system and of state aid payment formulas for cities, counties, townships, and individuals. Major features include:

- Reduce property tax classification rates for commercial/industrial, rental, seasonal recreational, and other property types, to reduce disparities in tax rates and reduce the barriers to economic competitiveness and development posed by Minnesota's high tax burden on business and apartment and rental properties.
- Reform the "tiered" classification structure for homestead properties to reduce the impact of market value inflation on property tax rates and better equalize homeowner tax burdens.
- Create a new state-paid credit for homestead properties to maintain property tax relief for homeowners, with a minimum tax rate requirement to ensure that state payments are targeted efficiently to those with the highest tax rates.
- Assume state funding responsibility for certain court-ordered child protection costs, and for additional court administration costs, in exchange for a reduction in state HACA payments to counties, in order to further reduce state-mandated impacts on the local property tax.
- Reform state aid payment formulas to cities and towns so that they more directly reflect basic costs for municipal services and the local resources available to fund those services, recognizing differences between the large central cities, suburban communities, and Greater Minnesota.
- Increase the maximum homeowner property tax refund to the same level as renters (from $520 to $1,230) to direct more relief to taxpayers with relatively high taxes and low incomes.

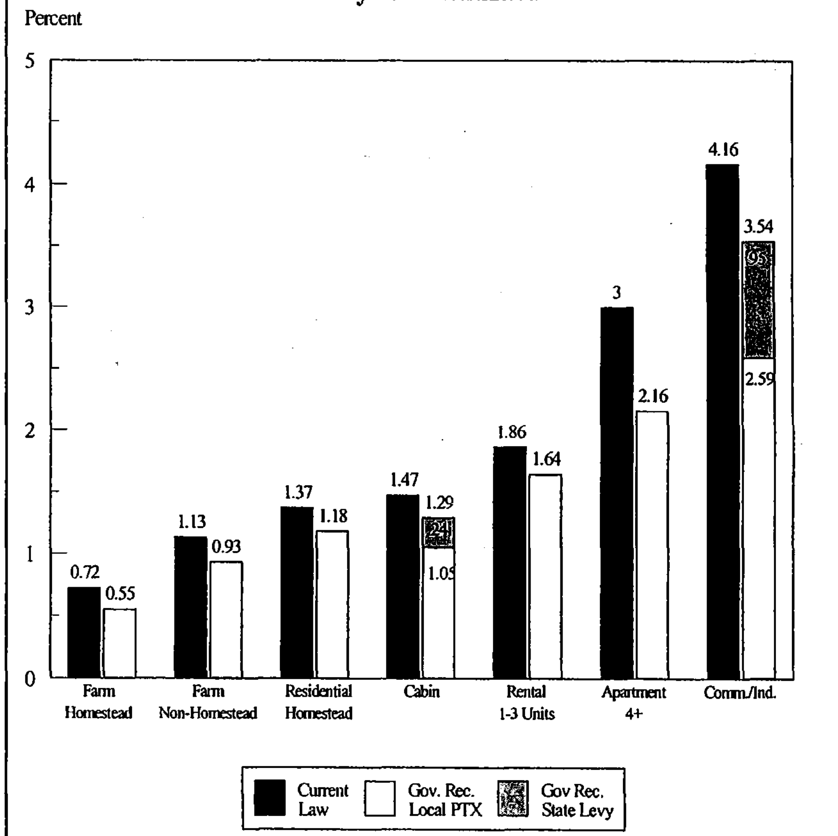
Statewide Average Property Tax Reductions Under the Governor's Proposal

The net effect of the Governor's recommendations for school finance reforms (including the new general fund levy), property tax classification reforms, and changes in state payment formulas to other local governments is a reduction in property taxes statewide of approximately $800 million per year.

Property Types	Reductions
Homestead	(14)%
Farm homesteads	(23)%
Farm non-homesteads and timber	(18)%
Seasonal recreational	(12)%
Rental (1 to 3 units)	(12)%
Apartments (market rate)	(28)%
Low-income apartments	(14)%
Commercial/industrial	(15)%

The impact of the Governor's recommendations is to significantly reduce the disparities in effective tax rates among various property types that exist under current law. This is especially true for the "local" portion of the property tax. The following chart illustrates the impact of the Governor's recommendation by major types of property.

Average Effective Tax Rates by Major Types of Property: Current Law vs. Governor's Recommendation Pay 2001 Estimated



Sales and use tax reform

The Governor's proposal will have the state and local tax system rely less on the property and income taxes and more on the sales tax. The proposal would align sales tax treatment of the service economy more with the goods economy, reduce the rate and expand the exemption for capital equipment and business inputs.

Overview of Governor's Tax Relief and Reform Proposal

In Minnesota, as in many other states, the sales tax has come under growing pressure as a revenue source. The economy has changed as consumption has shifted more from goods (that are generally subject to sales tax), toward services (that are generally not taxed). Minnesota's sales tax was first imposed in 1967 on goods only (minus food and clothing), a time when services made up just over 40% of total consumption. Since then, services have grown to consume 60% of consumer expenditures, yet the sales tax still applies to only a small select group of services. Minnesota's sales tax is increasingly out of step with the modern economy.

Moreover, the growth of e-commerce and internet sales--while essential for economic growth--are causing a growing tax loss because sellers from outside Minnesota don't collect and remit the sales and use tax. In the process, Minnesota retailers find themselves at a competitive disadvantage.

Finally, Minnesota has a high state sales tax rate—at 6.5%, the third-highest in the country. That high tax rate makes routine purchases for consumers more costly than they otherwise would be, and when imposed on business equipment and supplies increases the costs of doing business in Minnesota.

The Governor's proposal for sales and use tax reform is to preserve and modernize the sales and use tax so that it can continue to serve as a viable alternative to the property and income taxes. Citizens told us that, while they want overall tax burdens reduced, they would be more willing to trade-off the sales tax with the income and property tax because the sales tax is more in their own control than income and property taxes.

The Governor's sales and use tax reform proposal is based on the following principles:

- Taxing consumption is a fair, appropriate way to generate revenue to pay for government services.
- Taxpayers should be treated equally, whether they prefer to consume goods or services.
- The level of taxation should be balanced among the various sectors of the economy.
- Whether or not something is taxable should depend on the product or service being sold, not the business entity or organization that sells the item or service.
- Minnesota's sales and use tax system should be as similar and uniform with other states as possible, so that it is easier for nationwide businesses to bill and collect the state's sales tax.
- "Pyramiding" of sales taxes—taxing the inputs as well as the final product or service—should be avoided.
- The sales and use tax laws should be understandable for taxpayers and as easy for businesses to administer as possible.

With these principles as a guide, the Governor recommends the following reforms to the sales and use tax:

- Treat the service economy more like the goods economy by extending the sales tax base to many business and professional services currently not subject to sales tax, while maintaining exemptions for educational, child care, and health care services.
- Broaden the sales tax base by repealing several exemptions, but maintain current exemptions for essential items such as food, clothing, and home heating fuels.
- Reduce the sales tax rate to 6%
- Expand the definition of exempt capital equipment to include pollution control equipment, and make the capital equipment exemption up-front instead of a refund program.
- Expand the definition of exempt business inputs for taxable goods and services.
- Modernize the definition of "telecommunications services" in the sales and use tax statute.
- Repeal the June accelerated sales tax payment requirement.
- Exempt state and local governments from the sales tax.

- Broaden the exemption for purchases by non-profits to include meals, lodging, vehicle rentals and building materials, and exempt sales by non-profits up to the first $25,000 of taxable sales in the calendar year.

- Adopt model legislation for uniform sales tax definitions, filing requirements, and other administrative practices recommended by the National Streamlined Sales Tax initiative. This is a multi-state effort supported by the National Governor's Association, National Conference of State Legislatures, and other organizations, with the goal of achieving nationwide uniformity in administration of the sales tax to promote compliance with state sales and use tax laws by nationwide retailers (whether brick and mortar, catalog, or internet) and preserve state sales and use taxes in the era of electronic commerce.

Income Tax Relief and Reform

The individual income tax is Minnesota's largest revenue raiser in the state budget. Despite reductions enacted during the 1999 and 2000 legislative sessions, Minnesota's rates remain high in comparison to other states (the 10th–highest top rate and the 3rd–highest starting rate). Income tax burdens continue to be cited as a competitive disadvantage in attracting and retaining highly-skilled and productive workers to the state. In addition, Minnesota's income tax laws have become increasingly complex in the period since major simplifications were last achieved in the 1980s.

The Governor's recommendations for individual income tax reform and relief are designed to reduce income tax burdens for all taxpayers and achieve simplifications in tax calculations and penalties:

- Reduce income tax rates by 0.4 percentage points in all three brackets for calendar years 2001 and 2002, an additional 0.1 in 2003, and another 0.1 in 2004.

- Increase the Working Family Credit for taxpayers with one child by $100, and by $200 for those with two or more children in calendar years 2001 and 2002; in 2003 and thereafter, child credits are doubled to $200 and $400 and generation and phaseout rates are increased by 50%--achieving an overall doubling of the credit.

- Modify other income tax credits and subtractions: eliminate the dependent care credit beginning in calendar year 2002 and shift the savings to dependent care programs operated by the Department of Human Services; modify the K-12 credit and subtraction to clarify qualifying expenditures and promote better accuracy and compliance.

- Eliminate the Alternative Minimum Tax to simplify tax calculation requirements.

- Reduce and simplify the penalty structure for late filing and payments so it will be less onerous on taxpayers with short delays, and more effective in preventing lengthy delinquencies.

Other tax reform and relief proposals

In addition to property, sales, and individual income tax reform, the Governor recommends tax reform and relief in a number of other areas:

- Repeal of the HMO premium tax and the wholesale drug tax, and permanent stabilization of the provider tax at 1.5%. Under current law, the HMO premium tax would be required to "blink on" and the provider tax revert to a 2% rate. Future structural balance in the Health Care Access Fund is assured by a dedication of 85% of cigarette excise tax proceeds beginning in FY 2004.

- 10% reduction in the taconite production tax, with revenue to schools and local government maintained at current levels.

- Reductions in the motor vehicle registration tax to a maximum of $189 in the first year and $89 thereafter beginning in January, 2002, and a further reduction to a maximum of $75 for all years beginning in 2004.

- Additional business tax relief including a corporate income tax rate reduction to 9.4% and 90% sales weighting in the apportionment formula (accompanied by base broadening reforms to partially offset the reduction).

The complete Governor's recommendations for tax reform and relief are presented in the accompanying budget pages.

Governor's Tax Relief and Reform Initiatives
REVENUES IMPACTS

(dollars in 000s)	FY 01	FY 02	FY 03	FY 04	FY 05
General Fund					
Sales Tax Rebate (including recapture)	$ (911,514)	$ -	$ -	$ -	$ -
Income Tax Relief and Reform	$ (200)	$ (628,200)	$ (495,900)	$ (717,450)	$ (806,660)
Corporate Tax Reform	$ (3,800)	$ (27,730)	$ (12,600)	$ (12,800)	$ (10,800)
Sales Tax Reform		$ 35,860	$ 445,990	$ 478,370	$ 489,850
Streamlined Sales Tax		$ -	$ (800)	$ (800)	$ (1,000)
Property Tax Reform and Relief			$ 470,401	$ 484,513	$ 499,048
Reduce Motor Vehicle Reg Tax		$ (202,723)	$ (85,000)	$ (120,000)	$ (156,000)
Health Care, Cigarette and Tobacco Tax Reform		$ -	$ -	$ (141,300)	$ (141,300)
Petroleum Taxes		$ 300	$ 300	$ 300	$ 300
Special Tax Reform		$ (15,292)	$ (15,335)	$ (15,310)	$ (15,305)
General Fund Total	**$ (915,514)**	**$ (837,785)**	**$ 307,056**	**$ (44,477)**	**$ (141,867)**
Health Care Access Fund					
Health Care, Cigarette and Tobacco Tax Reform		$ (40,300)	$ (100,974)	$ 21,173	$ 16,736
HCAF Total	**$ -**	**$ (40,300)**	**$ (100,974)**	**$ 21,173**	**$ 16,736**
Highway User Tax Distribution Fund					
Reduce Motor Vehicle Reg Tax		$ -	$ -	$ -	$ -
Petroleum Taxes		$ 2,500	$ 2,540	$ 2,590	$ 2,640
HUTDF Total	**$ -**	**$ 2,500**	**$ 2,540**	**$ 2,590**	**$ 2,640**
Environmental Fund					
Special Tax Reform		$ 83	$ 95	$ 100	$ 105
Environmental Fund Total	**$ -**	**$ 83**	**$ 95**	**$ 100**	**$ 105**

Governor's Tax Relief and Reform Initiatives

Summary By Funds

		FY 01		FY 02		FY 03		FY 04		FY 05
General Fund										
General Fund Expenditures	$	500	$	(152,788)	$	1,361,305	$	1,244,342	$	1,269,226
General Fund Revenues	$	(915,514)	$	(837,785)	$	307,056	$	(44,477)	$	(141,867)
Net General Fund	$	(916,014)	$	(684,997)	$	(1,054,249)	$	(1,288,819)	$	(1,411,093)
Health Care Access Fund										
HCAF Fund Expenditures	$	-	$	3	$	(27)	$	(27)	$	(27)
HCAF Fund Revenues	$	-	$	(40,300)	$	(100,974)	$	21,173	$	16,736
Net HCAF Fund	$	-	$	(40,303)	$	(100,947)	$	21,200	$	16,763
Highway User Tax Distribution Fund										
HUTDF Fund Expenditures	$	-	$	140	$	-	$	-	$	-
HUTDF Fund Revenues	$	-	$	2,500	$	2,540	$	2,590	$	2,640
Net HUTDF Fund	$	-	$	2,360	$	2,540	$	2,590	$	2,640
Environmental Fund										
Environmental Fund Expenditures	$	-	$	-	$	-	$	-	$	-
Environmental Fund Revenues	$	-	$	83	$	95	$	100	$	105
Net Environmental Fund	$	-	$	83	$	95	$	100	$	105

Governor's Tax Relief and Reform Initiatives

All Fund Summary

		FY 01		FY 02		FY 03		FY 04		FY 05
All Fund Expenditures	$	500	$	(152,645)	$	1,361,278	$	1,244,315	$	1,269,199
All Fund Revenues	$	(915,514)	$	(875,502)	$	208,717	$	(20,614)	$	(122,386)
Net All Funds	$	(916,014)	$	(722,857)	$	(1,152,561)	$	(1,264,929)	$	(1,391,585)

Governor's Tax Relief and Reform Initiatives
EXPENDITURE IMPACTS

(dollars in $000s)	FY 01	FY 02	FY 03	FY 04	FY 05
General Fund					
Sales Tax Rebate	$ 500	$ 1,600	$ -	$ -	$ -
Income Tax Relief and Reform	$ -	$ 570	$ 16	$ 16	$ 16
Corporate Tax Reform	$ -	$ 130	$ -	$ (49)	$ (87)
Sales Tax Reform	$ -	$ 3,272	$ 3,292	$ 3,530	$ 3,699
Streamlined Sales Tax	$ -	$ 2,593	$ 1,030	$ 1,187	$ 1,190
Property Tax Reform and Relief	$ -	$ -	$ 1,310,568	$ 1,437,999	$ 1,457,891
Property Tax Aids Reform	$ -	$ -	$ 46,217	$ (198,481)	$ (188,650)
Property Tax Administration	$ -	$ 480	$ 448	$ 406	$ 430
Reduce Motor Vehicle Reg Tax	$ -	$ (161,723)	$ -	$ -	$ -
Special Tax Reform	$ -	$ 290	$ 134	$ 134	$ 137
Tax Refund Interest	$ -	$ -	$ (5,000)	$ (5,000)	$ (10,000)
Expand Political Contribution Refund	$ -	$ -	$ 4,600	$ 4,600	$ 4,600
General Fund Total	**$ 500**	**$ (152,788)**	**$ 1,361,305**	**$ 1,244,342**	**$ 1,269,226**
Health Care Access Fund					
Health Care, Cigarette and Tobacco Tax Reform		$ 3	$ (27)	$ (27)	$ (27)
HCAF Total	**$ -**	**$ 3**	**$ (27)**	**$ (27)**	**$ (27)**
Highway User Tax Distribution Fund					
Petroleum Taxes		$ 140	$ -	$ -	$ -
HUTDF Total	**$ -**	**$ 140**	**$ -**	**$ -**	**$ -**

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Agency: **Revenue, Department of (DOR)**

Item Title: **Sales Tax Rebate**

	FY 2001	2002-03 Biennium FY 2002	FY 2003
Expenditures: ($000s)			
General Fund			
- State Operations	$500	$1,600	$-0-
Subtotal	$500	$1,600	$-0-
Revenues: ($000s)			
General Fund			
- Sales Tax Rebate	$(925,414)	$-0-	$-0-
- Revenue Recapture	$13,900	$-0-	$-0-
Subtotal	$(911,514)	$-0-	$-0-

Statutory Change? Yes X No ____

If yes, statute(s) affected: M.S. 16A.1522, subd. 1

____ New Activity ____Supplemental Funding ____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends an automatic sales tax rebate in the amount of $925.414 million to be paid in the summer of 2001. This rebate will be similar in structure and population to the 2000 sales tax rebate. The rebate will be based on sales taxes paid in 1999.

RATIONALE:

November Forecast of 2000, the Commissioner of Finance certified $924 million as available for rebate under Minn. Stat. §16A.1522, sub. 1. The forecast projected this surplus as available for rebate as of July 1, 2001. The Governor is recommending a rebate of the entire projected surplus as a simple and fair method of returning the surplus funds to the taxpayers of Minnesota.

In the summer of 2001, an automatic rebate based on an estimate of consumer sales taxes paid in 1999 will be sent to each Minnesota resident who is not a dependent of another taxpayer, and who filed a 1999 Minnesota individual income tax return, a 1999 Minnesota Property Tax Refund return, or received Title II Social Security or tier I Railroad Retirement benefits in 1999. The estimated rebate will be based on the 1999 income of the recipient reported on line 4 of the Minnesota income tax return. Minnesota residents who are dependents and had Minnesota income taxes and wage income for 1999 will receive a rebate based on 35% of the normal rebate amount. Non-residents of Minnesota in 1999 will be required to submit a claim for the rebate showing the actual payment of 1999 Minnesota consumer sales taxes and will receive rebate of 42.85% of the sales tax paid. The rebates for non-dependent residents will range from about $121 to $3,500.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

The majority of the administrative costs for rebate are for vendor contracts to publish, print, and mail rebate checks. The $2.1 million administrative appropriation includes money for both Department of Revenue and State Treasurer costs.

FINANCING:

Financing for this item will be reflected as a $925.414 million sales tax revenue reduction in the General Fund in FY 2001. Past experience from sales tax rebates indicates that approximately 1.5% of that total will be recaptured from people who owe state taxes; therefore, a $13.9 million dollar General Fund increase is also expected as part of the sales tax rebate.

OUTCOMES:

Surplus state revenue generated as of the close of FY 2001 will be returned to citizens and taxpayers.

Agency: **Revenue, Department of (DOR)**

Item Title: **Income Tax Relief and Reform**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
-State Operations	$570	$16	$16	$16
Subtotal	$570	$16	$16	$16
Revenues: ($000s)				
General Fund				
- Rate Reductions	$(601,000)	$(483,000)	$(628,000)	$(717,000)
- Working Family Credit	(26,500)	(26,600)	(101,700)	(103,300)
- K-12 Education Credit	-0-	15,100	15,800	16,600
- Child Care Credit	-0-	12,000	12,000	12,000
- Education Subtraction	-0-	2,000	2,100	2,200
- Federal Update *	(700)	(1,200)	(1,600)	(1,800)
- Repeal AMT	-0-	(29,600)	(31,800)	(33,400)
- Penalty Reform	-0-	(5,100)	(5,400)	(5,800)
- Offset from Property Tax	-0-	18,200	18,800	19,200
- Offset from MVRT Red..	-0-	2,300	2,350	4,640
Subtotal	$(628,200)	$(495,900)	$(717,450)	$(806,660)

* Federal Update also has a ($200) revenue impact in FY 2001.

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 290.01, subd. 19b, 290.06, subd. 2c, 290.091, 290.067, 290.0671, 290.0674,

_____ New Activity ______Supplemental Funding ______Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends the following changes to the individual income tax.

- Reduce the regular individual income tax rates currently at 5.35%, 7.05%, 7.85%, and the 6.4% alternative minimum tax (AMT), by .4% for calendar years 2001 and 2002 and an additional .1% for 2003 and another .1% for 2004 and thereafter.
- Repeal the individual AMT starting in calendar year 2002 and allow any AMT credit to apply to total regular tax for 2002 and 2003. The remaining credit after 2003 would be lost.
- Reduce and simplify the late payment and late filing penalty structure for individual income tax.
- Change several credits designed to assist low-income households including:
  - Increase the Working Family Credit (WFC) for recipients with at least one child by $100 for the first child and another $100 for a second child starting in calendar years 2001 and 2002. Starting in 2003, the per child credit is doubled and the generation and phase out rates of the WFC are increased by 50%;
  - Repeal the dependent care credit starting in calendar year 2002 and shift the increased revenue (i.e., foregone credit) to similar child care programs in the Department of Children, Families and Learning;
  - Revise the K-12 education credit or subtraction by not allowing for materials or transportation required by school and scaling back the education credit from a dollar for dollar credit to a $.75 credit per dollar of education expenditure.
- Change several tax items to conform with recent federal law changes.

RATIONALE:

The November 2000 Forecast shows ongoing surplus revenue in future years of sufficient magnitude to call for a reduction in the individual income taxes paid by Minnesota taxpayers. Reducing Minnesota's high income tax rates will improve the state's competitiveness and reduce taxes across-the-board for most Minnesotans. This reduction, coupled with the increase to the working family credit, makes the income tax slightly more progressive and maintains a balance in the incidence of the overall tax system between households. Repealing the AMT will simplify filing for taxpayers. The current AMT adds unnecessary complexity to the income tax.

The Governor also believes that low-income credits can be efficient in assisting low-income households by delivering dollars, through the tax system in a more targeted manner.

One of the preliminary goals of the income tax reform discussion was to "consolidate the complicated credits to make filing simpler for the low-income taxpayers." Upon further study of taxpayers claiming the credits, it was found that most of the users rarely qualified or applied for all three credits (working family credit, child care credit, and the education credit). It would be very difficult to exactly combine the current credit amounts and income levels into a single credit. It is possible, however, to respond to the concerns about the two smaller credits in general terms while achieving simplicity and ease of compliance by enhancing the current working family credit.

Agency: **Revenue, Department of (DOR)**

Item Title: **Income Tax Relief and Reform**

One of the great advantages of the current working family credit is that taxpayers already have completed most of the paperwork by the time they get to the Minnesota application. It has also been noted that the compliance with this credit has been steadily improving since Minnesota began listing the credit amounts in a table. The federal government also does extensive audit of compliance for this credit federally and passes on the results to Minnesota. It has become a stable credit, which applies to a well-defined group of low-income working taxpayers.

Modifications to the K-12 education credit are intended to make it easier to use and reduce non-compliant returns. The Governor is also recommending that the credit be changed to a $.75 cent per dollar credit, since no refundable credits are dollar-for-dollar. The Governor is also recommending eliminating the current dependent care credit and filling the "void" with equal expenditure increases in the child care programs offered through CFL. *That spending initiative will be carried in a separate bill.*

The Governor also recommends a penalty reform initiative for the income and corporate franchise tax to make the penalty structure taxpayer friendly and more understandable. The proposed change will eliminate the rapid escalation of penalties that taxpayers currently face, and will correlate the penalty structure more accurately to lengthy delinquencies.

Updating Minnesota's income tax laws for federal changes adopted in 2000 will result in a revenue loss of approximately $1.9 million for the biennium. The majority of the lost revenue is due to provisions that increase the annual limit on the total amount of non-guaranteed state and local government bonds (private activity bonds) that are eligible for exclusion of interest from federal gross income. For Minnesota income tax purposes, the federal exclusion will reduce Minnesota taxable income for these types of bonds when issued by Minnesota or Minnesota local government units. Other miscellaneous federal update provisions include extension of the expiration date for medical savings accounts and authority to treat kidnapped kids as dependants.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

The proposals will require system modifications to reflect changes in credits and other items costing $25 thousand in FY 2002. These system changes generate efficiencies in future years (less data entry, audit, forms and mailing) which create savings of approximately $9 thousand per year thereafter. These savings, however, are offset by the startup and ongoing costs of program modifications related to penalty reform, which amounts to $545 thousand in FY 2002 and $25 thousand a year in the future.

FINANCING:

The tax changes associated with this item will reduce General Fund revenues by an estimated net total of $628.2 million if FY 2002 and $495.2 million in FY 2003. Financing for the operational components of this item will require new General Fund expenditures of $570,000 in FY 2002 and $16,000 in FY 2003.

OUTCOMES:

The proposed changes will give most individual taxpayers a reduction in their Minnesota income taxes, simplify the individual income tax by repealing the alternative minimum tax, and make the Minnesota education credit easier to calculate and comply with. The penalty initiative will focus on imposing penalties on those furthest from compliance, and not on penalizing taxpayers who "almost get it right."

Agency: **Revenue, Department of (DOR)**

Item Title: **Corporate Franchise Tax Reform**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- State Operations	$130	-0-	$(49)	$(87)
Subtotal	$130	-0-	$(49)	$(87)
Revenues: ($000s)				
General Fund				
- Sales Apportion. to 90%	$(54,900)	$(46,300)	$(50,700)	$(52,600)
- Federal Update *	(18,800)	(16,300)	(16,700)	(16,600)
- Exempt. Gross Premiums	(10,100)	(8,600)	(9,400)	(9,700)
- Amend Research Credit	18,100	15,600	17,500	19,700
- Repeal AMT	(14,400)	(12,200)	(13,400)	(13,800)
- Repeal FOC Provisions	34,600	29,300	32,000	33,200
- Repeal Foreign Royalty	56,300	47,500	52,100	54,100
- Repeal Job Train. Credit	200	100	-0-	-0-
- Contributions Deduction	6,070	5,200	5,700	5,900
- Net Income Definition	(5,300)	(4,500)	(4,900)	(5,100)
- Tax Rate Reduction	(39,500)	(33,600)	(36,800)	(38,400)
- Offset for Property Tax	-0-	12,200	12,800	13,500
- Corporate Penalties	-0-	(1,000)	(1,000)	(1,000)
Subtotal	$(27,730)	$(12,600)	$(12,800)	$(10,800)

* Federal update also has a ($3,800) revenue impact in FY 2001.

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: 290.01, 290.02, 290.05, 290.06, 290.0673, 290.068, 290.0921, 290.0922, 290.095, 290.17, 290.191, 290.21, 290.32, 290.35, 290.9727, 290.9728, 290.9729, 298.01.

_____ New Activity _____Supplemental Funding _____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends several changes to the corporate franchise tax:

- Move from 75% to 90% weighting of the sales factor in the apportionment formula
- Exempt insurance companies who pay a gross premiums tax from the corporate franchise tax
- Reduce the corporate franchise tax rate from 9.8% to 9.40% for tax years beginning in FY 2002
- Repeal the alternative minimum tax
- Simplify the tax by eliminating several modifications to the definition of federal taxable income and to conform more closely to the federal tax base
- Modify the research and development credit
- Reform the penalty structure of the late file and pay penalties for the corporate franchise tax

RATIONALE:

The Governor is recommending several changes to the corporate franchise tax to achieve the goals of simplicity, fairness, and increased competitiveness. Changes also reflect new federal legislation regarding Foreign Sales Corporations.

The corporate franchise tax, while not one of the state's larger revenue streams, is a very complex topic and has been subject to much litigation. Approximately 50,000 corporations file in Minnesota, with 10% of the taxpayers paying approximately 95% of the total tax. Department appeals officers and attorneys spent approximately 5,500 hours on corporate appeals and on court cases last year. In the forecast document from February 2000, the corporate tax was noted as one of the most volatile of Minnesota's taxes.

The changes proposed are designed to simplify the tax, reduce the modifications and make the tax more competitive. The rationale for some of the major changes is as follows:

- Reducing the overall tax rate makes all Minnesota businesses more competitive.
- Heavier weighting of the sales factor benefits Minnesota headquartered companies and helps them to remain competitive in a global economy.
- Repeal of the alternative minimum tax eliminates a very complex tax calculation that only results in shifting dollars from one year to the next.
- Under current law, insurance companies are subject to both the corporate franchise tax and the gross premium tax. The Governor's recommendation is to subject insurance companies to *either* of these taxes. This change is recommended to begin analysis and discussion of the future taxation of insurance companies and financial holding companies under Gramm Leach Bliley act, also known as the "Financial Institutions Modernization Act."

The Governor is recommending several changes that will simplify the tax and conform more closely with federal law.

Agency: **Revenue, Department of (DOR)**

Item Title: **Corporate Franchise Tax Reform**

The first of these changes eliminates several Minnesota modifications to federal taxable income and adopts newly enacted federal provisions for extraterritorial income, made by Congress as a result of a trade disagreement with the European Union. This change also repeals the current FOC provisions.

The Minnesota dividends-received deduction and contributions deductions are modified to conform more closely to the federal tax base. The research and development credit is modified to provide an incentive to companies that increase their research expenditures in Minnesota.

The Governor is recommending a penalty reform initiative for the income and corporate franchise tax to make the penalty structure more taxpayer friendly and more understandable. The proposed change will eliminate the rapid escalation of penalties that taxpayers currently face, and will correlate the penalty structure more accurately to lengthy delinquencies.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

These changes require additional administrative expenditures of $130,000 in FY 2002 that are primarily for system modifications. In future years, elimination of the AMT and changes in the definition of net income will reduce administrative costs for audits and forms.

FINANCING:

The corporate franchise tax proposal will result in an estimated reduction in state General Fund revenues of $27.73 million in FY 2002 and $12.6 million in FY 2003.

OUTCOMES:

These changes will make the corporate tax system more fair, efficient, reliable, competitive and understandable in structure. It will also make the tax system easier to comply with for taxpayers and easier to administer for the department.

Agency: **Revenue, Department of (DOR)**

Item Title: **Property Tax Reform and Relief**

	2002-03 Biennium	2004-05 Biennium	
	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)			
General Fund			
- General Education	$1,331,000	$1,331,000	$1,331,000
- Ed. Homestead Credit	(476,665)	(403,825)	(407,863)
- Ed. Agricultural Credit	(66,411)	(55,705)	(55,705)
- Homestead Credit	362,372	382,030	393,491
- Home. Ag. Land Cred	20,953	22,067	22,729
- Property Tax Refunds	23,100	24,100	26,000
- PTR Targeting Offset	(1,1000)	(1,200)	(1,400)
- PTR Offset	(15,300)	(15,500)	(15,300)
- Disparity Reduction	(2,376)	(2,546)	(2,643)
- Sch Ref Eq Aid	115,524	136,618	147,372
- Sch Debt Serv Eq Aid	19,471	20,960	20,210
Subtotal	$1,310,568	$1,437,999	$1,457,891
Revenues: ($000s)			
General Fund			
- General Fund Levy	$470,401	$484,513	$499,048
Subtotal	$470,401	$484,513	$499,048

Statutory Change? Yes X No ___

If yes, statute(s) affected: M.S. 273.13, 273.1382, 273.1384, 290A.04, 123B.53, 126C.13, 126C.17

_____ New Activity X Supplemental Funding _____ Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends:

- Replacing the general education property tax levy with state General Funds
- Creating a state General Fund levy on certain types of property
- Reducing the number and disparities between property tax classification rates
- Eliminating the Education Homestead and Agricultural Homestead Credits and creating new Market Value Homestead and Agricultural Land Credits
- Increasing the maximum homeowner Property Tax Refund
- Increasing School Referendum and Debt Service Equalization Aids

RATIONALE:

The Governor's property tax recommendations contribute to a property tax system that is more local, accountable, fair, and competitive. These proposals make the local property tax smaller and provide new funding sources for the general education levy. The recommendations are integral components of the Governor's overall plan of tax reform and relief.

Eliminate Local General Education Levy

The Governor's proposal would eliminate the K-12 general education levy with the state assuming responsibility for the costs of basic education. This corrects an existing imbalance in state-local fiscal responsibilities by recognizing that education, with its broad statewide benefit, should be financed through a statewide revenue source that is more explicitly recognized as such. Under the Governor's proposal, the way in which taxes are raised to support K-12 education will enhance fiscal accountability between the state, local school districts, and taxpayers. By having the state take clear fiscal responsibility for its required funding of per pupil costs and by allowing local districts to use the property tax to supplement the state-guaranteed funding levels, the trade-off between the expected benefits from additional spending and the additional taxpayer cost will be clear to local voters. Eliminating the general education levy removes a significant barrier and provides the opportunity to lower commercial-industrial property and apartment taxes, which bear a disproportionate burden of the local property tax.

Impose State General Fund Levy

To partially offset the elimination of the general education property tax levy, the state will impose a state general fund levy on certain properties including Commercial/Industrial, Public Utilities and Railroads, Seasonal Recreational Residential, and Seasonal Recreational Commercial. The tax will be a certified rate applied on assessed value with exemptions for seasonal recreational residential properties equal to 50% of taxable value up to a maximum of $400. Attached Generation Machinery is exempt from the general fund levy. The levy amount will be set by the legislature for taxes payable in 2002. Collection of the levy will continue to occur at the county level, but the funds will be remitted to the state. The rate will be certified by the Department of Revenue. Annual levy increases are limited to the rate of the inflation, but can be exceeded with a super-majority vote by both houses.

Property Tax Classification Rates

Minnesota's property tax classification system is characterized by different classification rates and credits applied to properties based on use. This has

Agency: Revenue, Department of (DOR)

Item Title: Property Tax Reform and Relief

resulted in significantly different effective tax rates between properties and between communities. The Governor's recommendation reduces the number of rates on major types of property from 8 to 5 and significantly reduces the disparity between high and low rates. This change reduces the underlying structural "tax capacity" disparity between types of property.

Eliminate Education and Agricultural Homestead Credits

Under the Governor's proposal, the need for these credits is eliminated. They were used to reduce the property tax costs of local funding of general education which the state proposes to assume.

Create New Market Value Credits

In order to continue the state's policy of lower relative tax burdens for low valued homes, two new credits are created to replace the Education and Agricultural Homestead Credits. The new credits provide property tax relief to residential homestead's and farm homestead land based on taxable market value. For residential homesteads, the credit equals 0.0050 times taxable market value up to a maximum of $330. The credit cannot reduce a residential homestead's tax rate below 0.85% of market value. For farm homestead land, the credit is equal to 0.0025 times taxable market value up to a maximum of $288. The local revenue impacts of both credits are offset for local governments with a new aid program.

Modify the Property Tax Refund

Although the Governor's property tax reform plan provides significant property tax relief for the vast majority of homeowners, many households are still confronted with relatively high taxes compared to their income or ability to pay. Under current law, many of these homeowners receive property tax refunds but are at the refund maximum. For taxes payable in 2001, approximately 215,000 homeowners received property tax refunds and 38% were at the maximum, many of which had tax burdens in excess of 6% of their income. To address this problem the Governor recommends increasing the maximum refund from $520 to $1,230. With this change, the percent of homeowners at the maximum will drop to 6% and the average tax burden rate, after refunds, will drop by 20%. This proposal will primarily benefit seniors, first-time homeowners, and young working families.

School Referendum and Debt Service Aid

To balance accountability with equity in school funding under the Governor's proposed state funding of general education, the Governor recommends increasing funding for operating and debt service referendum levies. Although the responsibility for initiating these levies rests with the local school districts, the state has helped provide equity among districts through equalization aid. The primary result of this recommendation is to provide low property-wealth districts with greater ability to fund educational needs on a more equal basis with wealthier districts. For excess operating referendum levies the state share increases from 28% to 50%. The two-tier equalization formula is increased to up to $1,115 per weighted pupil units. Levy increases will be assessed on "voter-resident" properties only (homesteads and rental housing), making the tax more accountable to resident taxpayers, especially in those districts that exceed the $1,115 pupil unit limit. Owners of business properties, agricultural land, and cabins (non-voter properties) will be exempt from school operating levies. Debt service state share increases from 4% to 10%. Levy increases for debt service (facilities) equalization will be assessed on all proprieties.

Interactions

In the absence of the proposed changes to the property tax refund program, property tax refunds would be reduced due to the tax reform plan's reduction of the general level of the property tax. This explains the "PTR Targeting Offset" and "PTR Offset" listed in the expenditure table. The same is true for "Disparity Reduction." The disparity reduction credit reduces property tax burdens for commercial/industrial, public utility, and apartment properties in certain border cities. The tax reform plan's reduction of the property tax burden for these properties statewide decreases the amount of funding necessary to reduce the property tax burden in the border cities.

OUTCOMES:

The proposal contributes to an overall tax package that makes the property tax system more local, accountable, fair, and competitive. This specific proposal makes the local property tax smaller and provides new funding sources for the general education levy.

Agency: **Revenue, Department of (DOR)**

Item Title: **Property Tax Aids Reform**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- School HACA	$-0-	$(7,972)	$(5,973)	$(3,944)
- City HACA	-0-	(199,374)	(199,374)	(199,374)
- Town HACA	-0-	(29,259)	(29,259)	(29,259)
- Special District HACA	-0-	(28,713)	(28,713)	(28,713)
- Mobile Home HACA	-0-	(5,072)	(5,460)	(5,464)
- Attached Machinery Aid	-0-	(3,218)	(3,218)	(3,218)
- County HACA	-0-	(84,676)	(84,867)	(85,060)
- Family Preservation Aid	-0-	10,000	10,100	10,201
- Eliminate LGA	-0-	(418,340)	(429,213)	(442,201)
- Eliminate Town LGA	-0-	(3,856)	(3,956)	(4,059)
- New LGA	-0-	471,963	491,393	511,850
- New Town LGA	-0-	18,464	18,953	19,450
- LGA Payment Schedule	-0-	255,200	-0-	-0-
- TIF Grant Aid	-0-	65,600	65,600	65,600
- Eliminate TIF Penalties	-0-	5,400	5,400	5,400
- Low Income Housing Aid	-0-	70	106	141
Subtotal	$-0-	$46,217	$(198,481)	$(188,650)
Revenues: ($000s)				
General Fund	$-0-	$-0-	$-0-	$-0-
Subtotal	$-0-	$-0-	$-0-	$-0-

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 273.1398, 273.138, 273.1398, 273.166, 477A.0122, 477A.013, 477A.03, 477A.065

______ New Activity __X__ Supplemental Funding ______ Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends:

- Using a portion of City/Town Homestead and Agricultural Credit Aid (HACA), school HACA, special district HACA and mobile home HACA to pay for state assumption of the general education levy.
- Designating a portion of HACA and folding it into Local Government Aid (LGA).
- Eliminating Attached Machinery Aid.
- Increasing funding targeted towards family preservation and out-of-home placements, and continuing state assumption of a number of court-related costs through a county HACA offset.
- Increasing funding and creating a new formula for LGA.
- Accelerating LGA payments to cities and towns.
- Increasing funding for TIF (Tax Increment Financing) Grant aid and eliminating TIF penalties.
- Increasing Low Income Housing Aid for cities.

RATIONALE:

The Governor's recommended changes to state property tax aids are integral components of an overall plan of property tax reform and relief. The proposal clarifies responsibilities between state and local governments and moves toward the goal of the state assuming more costs for programs recognized as mandate driven. The proposal also begins to clearly tie state dollars distributed to local governments to regional needs and disparities. Undesignated aids that have no formula will be tied to clear outcomes. In this way, the state aids to local governments, amounting to approximately $2.1 billion annually (FY 2003) can be more explicitly tied to programs and more accountable to taxpayers and public policymakers.

City/Town, School, Special District, and City Mobile Home HACA

One of the general policy directions of the tax reform plan is to eliminate undesignated state transfers to local governments in favor of aid targeted to equalize the property tax base or to fund specific state or shared financial responsibilities. The tax reform plan uses existing HACA for part of the reallocation or targeting of state resources towards school funding. Existing HACA is reallocated from schools, special districts, townships, and cities. For cities in greater Minnesota, HACA is reallocated in an amount equal to a maximum of 8% of Adjusted Net Tax Capacity. If a particular city does not have enough HACA, the reduction will be less than 8%. For cities with HACA remaining after the 8% reduction, the remaining HACA will be included in their new LGA base and phased into a new LGA formula over a period of 6 years.

Attached Machinery Aid

Attached Machinery Aid was designed to compensate counties and school districts for lost revenue because of removal of attached machinery from the tax base in 1973. The aid is distributed to 13 counties and is a relatively small dollar figure because it is based on 1972 assessed values. This aid is eliminated as part of a general reconfiguration of aids with the long-run goal of providing a limited number of targeted aids to local governments.

Agency: Revenue, Department of (DOR)

Item Title: Property Tax Aids Reform

Local Government Aid

The policy rationale for proposed changes to the city LGA formula is to provide more outcome-based objectives in the formula, based on regional needs. The changes are made so that public policymakers can better understand that state dollars are meeting the goals of LGA to provide assistance to local governments to ensure that basic services are being met for all communities. Currently, because of the complex formula and history of LGA, this is often not clear for legislators when they appropriate aids to local governments.

Each geographic area of the state faces unique challenges – shrinking tax base, core city issues, and exploding populations and sprawl in the suburbs. While LGA attempts to assist cities with these challenges, the formula needs to be changed to begin to

- equalize tax effort required to finance "basic" city services (public safety and streets),
- address the cost/benefit spillovers prevalent in regional economic centers, and
- to encourage higher density development to achieve greater efficiency and utilization of existing infrastructure.

The new formula is a simple need versus capacity formula, designated into three "pots" for metro, rural and suburban cities—giving lawmakers more flexibility in using LGA to address regional policy concerns.

The formula aid amount is equal to ((average basic expenditure/population) - (required tax rate * city tax capacity / population)) * population. The need amount is the average per capita expenditure for basic services for the following groups of cities: Central Cities (Minneapolis $508, St Paul $431, and Duluth &425), Metro Suburbs ($194), Non-Metro Regional Centers (Cities with greater than 5,000 population, $265), and other Non-Metro Cities ($234). The required city tax rate is 17%. Other formula adjustments include a sprawl factor for regional centers in greater Minnesota and a density factor for Metro Suburban cities.

The three major central cities and metropolitan cities will be fully on formula for taxes payable in 2002. For Greater Minnesota cities, the new base aid amount will be phased into the formula over 6 years.

The LGA appropriation will be grouped into three divisions, Central Cities (Minneapolis, St. Paul, and Duluth), Metro Suburbs (7 county Metro region), and Greater Minnesota Cities. The appropriation for city LGA will be $472 million in FY 2003 and will grow by inflation plus the statewide average growth in households.

Township LGA will have two parts, 50% will be subject to a tax base equalization formula and the other 50% will be distributed on a per capita basis. The Tax Base Equalization Aid for each jurisdiction will equal ($81 - (0.10 * non-agricultural tax capacity)) * population. The Per Capita Aid will simply equal approximately $9 per capita. The appropriation for township LGA will be 18 million in FY 2003 and will also grow with inflation and household growth.

The payment schedule for both city and township LGA will be accelerated so that half of the budgeted payment for FY 2004 will be shifted into FY 2003. This is a one-time shift that will improve the matching of the timing of expenditures and aid and will also benefit city and township cash flows. The shift amounts to $255.2 million in FY 2003.

County HACA

The general policy direction of aid reform also applies to County HACA. The Governor's recommendation does not propose elimination of County HACA but it does target a large portion of HACA towards family preservation and out-of-home placements, and to continue state assumption of a number of court-related costs. The remaining HACA should be reserved for future state and local fiscal realignment.

Counties have voiced strong concern over funding out-of-home placement costs through the property tax. The Governor's recommendation begins to address this concern by targeting $77.4 million of HACA towards child welfare: (1) for prevention by targeting $10 million to Family Preservation Aid; and (2) for actual out-of-home placement costs by funding foster care placements totaling $67.4 million. These measures will increase the level of state shared responsibility for child welfare and out-of-home placement costs over time. Additional targeting of HACA is proposed as a funding source for court functions that will be assumed by the state in FY 2002, including services such as guardian ad litem, interpreter, rule 20 and civil commitment psych exams. These costs total approximately $9.1 million. The Department of Human Services budget details the new foster care funding provisions and the targeting of HACA for court costs is part of the further implementation of existing legislation. The HACA reduction in the expenditure table above is $1.8 million less than the total of the new targeted funding to account for counties that receive less HACA than would be offset in the initial year of fiscal realignment.

Agency: Revenue, Department of (DOR)

Item Title: Property Tax Aids Reform

TIF

Under the Governor's property tax reform plan, the state assumes funding responsibility for K-12 general education costs and reduces the tax capacity of business property. This decreases the amount of increment available for Tax Increment Financing (TIF) districts. The expected reduction in increment is likely to be absorbed by some districts, but other districts will have deficits. To address this problem, the Governor recommends increasing funding for TIF Grant Aid by $65.6 million in FY 2003.

The Governor also recommends eliminating TIF penalties at a cost of $5.4 million per year. These are basically payments owed by cities to school districts when TIF districts affect school district revenues. These penalties are usually withheld from city LGA. Because, the state will take over the general education costs for all school districts, this mechanism of TIF penalties becomes obsolete. Cities will no long owe the payments, and the state will no longer reduce LGA for that purpose.

Low-Income Housing Aid

The Governor's property tax plan significantly reduces taxes for rental properties and continues preferential property tax treatment for low-income rental housing. In conjunction with these measures, the Governor recommends increasing 4d housing aid as an incentive for cities to development low-income housing (4d properties). The aid will be paid to cities with new construction of qualifying low-income rental housing based on the market value of the unit and the local tax rate. The estimated cost is $70 thousand in FY 2003.

FINANCING:

The net cost of all of these local government aid changes will be to reduce state General Fund aids to non-school local governments. Local government aid expenditures will increase in FY 2003 by $46.217 million, but this is largely a one-time aberration created by the acceleration of LGA payments. It must be noted that some of if not all of the reduced local government aid will be replaced with other local aid and revenue streams from other parts of the tax package.

OUTCOMES:

The proposals will contribute to the Governor's strategic vision of greater accountability and responds to concerns by public policymakers that state and local fiscal accountability become more clear. The recommendations will reduce undesignated transfers of state aid local governments and will target these transfers so that state dollars may be better accounted for and so that local governments receive more responsive aid from the state for mandated programs that are a state or a shared state-local responsibility. The proposals are integral to state funding of general education and will partially off-set the costs of the state assumption of per pupil general education costs.

BUDGET CHANGE ITEM

Agency: **Revenue, Department of (DOR)**

Item Title: **Tax Reform – Property Tax Administration**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- State Operations	$480	$448	$406	$430
Subtotal	$480	$448	$406	$430
Revenues: ($000s)				
General Fund	$-0-	$-0-	$-0-	$-0-
Subtotal	$-0-	$-0-	$-0-	$-0-

Statutory Change? Yes __X__ No ___

If yes, statute(s) affected: M.S. 273.061, 273.0755, 273.121, 276.04, 276.065, 275.078, 290A.04

_____ New Activity _____Supplemental Funding _____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends several changes to improve the administration of the property tax:

- Repeal the Levy Certification Tax Rate Increase Hearing and Resolution requirement
- Simplify Truth-in-Taxation hearings and statements and make improvements to other information sent to taxpayers
- Allow local governments to waive the requirement for Truth-in-Taxation hearings if the proposed levy does not exceed inflation.
- Improve the requirements for the notification and appeals for property valuations
- Increase accountability of assessors through more state oversight and education requirements

RATIONALE:

Throughout the tax reform process we heard countless comments about taxpayer and tax administrator frustration with the complexity of the property tax. The Governor is recommending several changes that should make the property tax more understandable for taxpayers, providing them with needed information to determine what is happening to their property tax and how they can influence the process. The recommendations include changes to improve the administration of the property tax for tax administrators, but also requires that the information they provide to taxpayers be understandable and useful.

Recommendations include:

- Repeal the Levy Certification Tax Rate Increase Hearing and Resolution requirement. Few people understand the process and even fewer consider it to be an effective use of the taxpayers' and county officials' time.
- Simplify the Truth-in-Taxation process and make it more effective by requiring meetings only when a significant tax change is proposed. Other proposals will make the proposed tax statement easier for taxpayers to understand, such as repealing the requirement for the "blame" column on the property tax statement and Truth-in-Taxation notices.
- Ensuring that taxpayers have the information that they need, counties will be required to put additional information on the valuation notices and mail the notices whether or not there is a change. For some counties, that will be business as usual, but for others, it will mean additional expenditures.

IMPLEMENTATION AND ADMINISTRATION:

Additional funds are requested to improve the consistency of assessment practices throughout the state. Efforts will be concentrated on education, uniformity of assessment, measurement of the quality of assessment and accountability for meeting minimum assessment standards. The Department is requesting $480,000 in FY 2002 and $448,000 in FY 2003. These administrative costs are primarily for additional staff to provide the proposed oversight of assessment practices, research, and education.

FINANCING:

Financing will be provided by a general fund appropriation.

OUTCOMES:

These recommendations respond to taxpayer focus groups and surveys and make the information that they receive more memorable, meaningful and useful. The changes will improve information provided to taxpayers and help them to be engaged in local decisions. These changes will lay the groundwork for future reform efforts aimed at simplification, efficiency, and reducing complexity in the system.

Agency: Revenue, Department of (DOR)

Item Title: Sales Tax Reform

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- State Operations	$3,272	$3,292	$3,530	$3,699
Subtotal	$3,272	$3,292	$3,530	$3,699
Revenues: ($000s)				
General Fund				
- Services 6.5%	$363,100	$903,500	$937,100	$972,200
- Service Rate Reduct.	(27,900)	(69,500)	(72,100)	(74,800)
- General Rate Reduct.	(131,600)	(339,300)	(358,000)	(377,700)
- MVST Rate Reduction	(16,900)	(45,200)	(46,600)	(48,000)
- Capital Equipment	(39,000)	(47,500)	(31,100)	(33,800)
- June Payment	(134,000)	(9,900)	(8,100)	(8,500)
- Telecommunications	23,940	59,180	62,740	66,500
- Telecom Rate Redt.	(1,840)	(4,550)	(4,830)	(5,110)
- Reg Verify ATVs Tax	60	60	60	60
Subtotal	$35,860	$445,990	$478,370	$489,850

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 84, 289A, 297A, and 297B

__X__ New Activity __X__Supplemental Funding ______Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends that the state reduce its reliance on property and income taxes and rely more on the sales tax. The Governor recommends the following changes to the sales and use tax:

- Treat the service economy more like the goods economy by extending the sales tax base to services currently not subject to sales tax.
- Broaden the sales tax base by repealing several existing exemptions.
- Reduce the sales tax rate to 6%.
- Change the capital equipment refund into an up-front exemption.
- Expand the definition of capital equipment exemption to include pollution control equipment.
- Expand the definition of exempt business inputs for taxable goods and services.
- Modernize the definition of "telecommunications services" in the sales tax statute.
- Repeal the sales tax "June accelerated payment."
- Exempt state and local governments from the sales tax.
- Broaden the sales tax exemption for purchases by non-profits to include meals, lodging, vehicle rentals and building materials.
- Exempt non-profits from collecting sales tax on up to the first $25,000 of "normally" taxable sales in the calendar year.

RATIONALE:

When the sales tax was enacted in 1967, services accounted for a small portion of overall economic activity. Since then, the U.S. economy has shifted away from manufacturing and the sale of tangible personal property to activity based on service-related transactions. In 1999, 58% of personal expenditures were for services and 42% for goods. By 2005, services are expected to be 64% of total U.S. consumer spending.

The sales tax is also under continuing pressure as remote sales, such as the internet, grow while the state lacks the ability to collect sales or use tax on these purchases. A recent study shows that Minnesota may loose $220 million in FY 2003 from sales and use tax not collected due to internet purchases. Without policy and administrative reforms, this will shift state budget pressures onto the property tax, income tax and other taxes.

The Governor is recommending that the sales tax be reformed to better reflect the changing economy and to reduce the rate to 6% to improve Minnesota's competitive position. Included in these changes are corrections to Minnesota's current sales tax law to repeal the capital equipment refund process and the remaining "June accelerated payment." Eliminating these administrative barriers will simplify the sales tax.

Minnesota sales tax law currently exempts most services, however, there is no economic reason for treating the service economy differently than the manufactured goods economy. Minnesota has one of the highest state sales tax rates in the country (6.5%) with one of the lower collection amounts. This lower collection amount is due to the large number of exemptions in Minnesota law and a tax base that excludes most of the service economy, as well as little reliance on local option sales taxes. Virtually every economist, public finance expert and tax expert will advocate that a sound tax system is based on broad bases and low rates.

The Governor's sales tax reform initiative will align Minnesota's sales tax with other states' sales tax laws and also with changes in the economy's consumption patterns. If the sales tax is to be a reliable source of revenue

Agency: Revenue, Department of (DOR)

Item Title: Sales Tax Reform

in the future, the state can no longer ignore the changes in the economy and preserve the antiquated sales tax laws.

Under the Governor's proposal, the sales tax base is expanded and the rate is reduced to 6% with an expanded definition of capital equipment and business inputs. Taxable services would include a number of business and personal services, including intrastate transportation services, based on destination based sales. All providers of proposed services to be taxed would receive similar treatment for capital equipment and business input exemptions as do manufacturers of taxable goods.

Services that would be subject to the sales tax include: legal services, computer and data processing services, real estate and property management service commissions, engineering, architecture and surveying services, construction - special trades, research and development and testing services, management, consulting and public relations services, accounting services, personnel services, advertising services, and other business services, intrastate transportation services, motor vehicle repair services, general repair services, investment counseling services and brokerage fees, personal services (beauty and barber), sewerage services, and funeral services. The definitions used are consistent with the North American Industry Classification system, 1997, as prepared by the Office of Management and Budget.

As part of the sales tax base change, the Governor is recommending reinstating the sales tax exemption for state and local government purchases. While this is definitely a narrowing of the sales tax base, it is also good tax policy. It eliminates an inefficient and circular budget and accounting process. State and local government paying sales tax puts the State in the awkward position of increasing General Fund appropriations to agencies (or General Fund aids to local governments) so they can pay sales tax back into to the General Fund. In some cases, the existing policy absorbs special fund dollars to reimburse the General Fund. For example, last session, the legislature concerned with the amount of Highway Funds being used to pay state sales tax, discussed remedies ranging from General Fund new appropriations, to statutory exemptions, to constitutional exemptions.

The Governor is also recommending the adoption of a definition of "telecommunications" services that has been advanced by the National Telecommunications Tax Reform Initiative, a joint state-industry working group that has been meeting in conjunction with the National Streamlined Sales Tax initiative to set a standard of definitions to modernize state telecommunications statutes. The definition provides more explicit and broader language regarding cable and similar programming services. The change makes Minnesota law consistent with the recently passed federal Mobile Telecommunications Act in which sourcing of the tax is to the customer's billing address.

The Governor's recommendations also include repeal of 51 exemptions that are currently allowed in statute. In this proposal, other states' sales tax laws were examined, looking to where Minnesota was different from other states. These goods or services will be eligible for the same treatment as capital equipment and other business inputs as would any other taxable goods and services. Some of the exemptions that would be repealed include publications, television commercials, certain interstate telephone service, YMCA, YWCA and JCC membership dues and others.

Taxable sales will also be treated more equitably regardless of the incorporated status of the entity providing the sale, whether for profit or non-profit. Sales to nonprofit groups that qualify as a 501(c)(3) will be exempt for their purchases including meals, lodging, vehicle rentals and purchases of construction materials. Sales by nonprofit organizations will be exempt from the sales tax for the first $25,000 of taxable sales in a calendar year. Non-profits making taxable sales will receive the same treatment for capital equipment and inputs as for-profit companies selling the same taxable product. Non-profits would still receive the same income tax and property tax exemptions they receive under current law.

One minor change requires that the DNR and deputy registrars verify that sales tax has been paid before registration of all-terrain vehicles. The purpose of this change is prevent persons from going outside the state to purchase all-terrain vehicles and then bringing them into Minnesota for use without paying either the Minnesota sales or use tax, while purchases made in-state are subject to the tax.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

The administrative costs associated with these changes are primarily for increasing staff to correspond with expected increases in number of taxpayers interacting with the sales and use tax system (registration, processing, legal services, taxpayer education, compliance, audit, and collection). The department is requesting $3.272 million in FY 2002 and $3.292 million in FY 2003 to pay for these increased costs.

FINANCING:

The net effect of this sales tax reform initiative will increase General Fund sales tax collections by approximately $35.86 million in FY 2002 and $445.99 million in FY 2003.

Agency: **Revenue, Department of (DOR)**

Item Title: **Sales Tax Reform**

OUTCOMES:

The sales tax revenues to the General Fund will be increased, all of which will be used to reduce the sales tax rate and to provide funding for property tax and income tax relief. With a reduction in the rate, the broadening of the base of the sales tax and the budget effort to reduce administrative burden of the collection of the tax, the Governor's proposal will stabilize the sales tax to ensure its viability as a continued major revenue source for state and local budget, and provide opportunity for significant relief in other areas.

Agency: **Revenue, Department of (DOR)**

Item Title: **Streamlined Sales Tax**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- State Operations	$2,593	$1,030	$1,187	$1,190
Subtotal	$2,593	$1,030	$1,187	$1,190
Revenues: ($000s)				
General Fund				
- Service Sourcing	$(1,900)	$(5,000)	$(5,200)	$(5,500)
- Rate Reduction Effect	100	400	400	400
- Definitional Change	1,800	3,800	4,000	4,100
Subtotal	$-0-	$(800)	$(800)	$(1,000)

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 297A

_____ New Activity _____Supplemental Funding _____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor is recommending adoption of the model legislation for the National Streamlined Sales Tax project. The project is a multi-state initiative to simplify and modernize sales and use tax administration. The project attempts to tear down administrative burdens and use emerging technologies to substantially reduce the burdens of tax collection for remote and bricks and mortar sellers.

RATIONALE:

The role of electronic commerce and remote sellers is having a noticeable impact on state sales tax collections. A recent study shows that Minnesota may loose $220 million in FY 2003 from sales and use tax not collected due to internet purchases. As part of the Advisory Commission on Electronic Commerce, created by the Internet Tax Freedom Act, discussions were held about the challenges for retailers to comply with the myriad of sales and use tax laws – both state and local – around the country. The states have agreed that the sales tax does not lend itself to administrative ease and compliance.

The National Governors Association, National Conference of State Legislatures, Federation of Tax Administrators, Multistate Tax Commission and 30 states are voting members, with 13 observer states. Minnesota is one of the voting participants in the project. Last session, our legislature enacted the enabling legislation required to authorize our participation. The participating organizations have approved a model act, with an accompanying administrative agreement. This represents the first phase of the initiative.

The model legislation would provide the following benefits:

- Uniform definitions within tax bases. This will be done in three phases, with the first being food and clothing definitions. Legislatures will still decide what is taxable and exempt but will use the common definitions.
- Simplified administration for use and entity-based exemptions. Sellers will be relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for incorrect exemptions claimed.
- Rate simplification. States will be responsible for the administration of all state and local taxes and the distribution of the local taxes to the local governments.
- State and local governments will use common tax bases and accept responsibility for notice of rate and boundary changes. States will be encouraged to simplify their own state and local tax rates.
- Uniform sourcing rules. The states will have uniform sourcing rules for all property and services to determine which state is owed the tax.
- Uniform audit procedures. Sellers who participate in one of the certified Streamlined Sales Tax System technology models will either not be audited or will have a limited scope audit, depending on the technology model used.
- Reduce the financial burdens on sellers - states will assume the responsibility for implementing the Streamlined Sales Tax System.

The Streamlined Sales Tax System model act will allow Minnesota and other states to provide sellers the opportunity to use one of three technology models:

- Model 1-A Certified Service Provider, which performs all of the seller's sales tax functions.
- Model 2-A Certified Automated System, which performs only the tax calculation function.
- Model 3-A, which serves a larger seller with nationwide sales that has developed its own proprietary sales tax software so that it may have its own system certified by the states.

Agency: Revenue, Department of (DOR)

Item Title: Streamlined Sales Tax

While three technology models are available, some sellers may choose to continue to use their current systems and still enjoy the benefits of simplification.
Implementation of the streamlined sales tax, while not directly tied to the sales tax reform initiative, is expected to reduce sales tax revenue when coupled with the sales tax base expansion proposed by the Governor. This is due to the sourcing of the tax of services to where the service is consumed. For example, under this sourcing change, services provided to out-of-state consumers will not be subject to tax.

The definitions recommended in the streamlined sales tax model act conflict only slightly with current statutory definitions. In the model act, definitional changes focus on food and clothing definitions, many of which Minnesota exempts. Any reductions are offset slightly by the Governor's proposed sales tax rate reduction from 6.5% to 6% general sales tax rate.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

Under this initiative, department administrative costs are estimated to increase with increased seller participation, interaction and registration in the sales tax system. Computer systems modification and programming will be needed to meet requirements for receiving data from sellers. Additional cost will also be incurred for communications, printing, postage, salaries, and equipment. The department is requesting $2.593 million in FY 2002 and $1.03 million in FY 2003.

FINANCING:

In early stages, there will be minimal impact on the General Fund. However, as the initiative become more established and successful, sales tax collections from remote sellers are expected to grow, greatly exceeding initial startup and administrative costs.

OUTCOMES:

Minnesota has played a key role in the states' call to action to provide a zero burden way for remote and bricks and mortar sellers to collect and remit sales and use taxes. As Congress takes a more active role in mandating states' authority in the area of sales tax, states have a challenge to provide simple and uniform administrative methods of compliance to stabilize any loss of revenues that may occur. By participating in the project and adopting the model legislation, Minnesota can begin to modernize the sales tax system and help the sales tax retains its viability as a major revenue source.

Agency: **Revenue, Department of (DOR)**

Item Title: **Special Taxes Reform and Relief**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- State Operations	$340	$184	$184	$187
- Reduced Amort Aid	(50)	(50)	(50)	(50)
Subtotal	$290	$134	$134	$137
Revenues: ($000s)				
General Fund				
- Paddlewheel & Raffle	$480	$530	$530	$530
- Reduce Bingo Rates	(495)	(540)	(540)	(540)
- Change Ins Due Dates	(500)	(20)	0	0
- Repeal Bottle Tax	(460)	(500)	(500)	(500)
- Raise Comb. Rec. Brack.	(5,500)	(6,000)	(6,000)	(6,000)
- Repeal Auto. Self-Ins Tax	(100)	(100)	(100)	(100)
- Red Taconite Prod Tax	(8,800)	(8,800)	(8,800)	(8,800)
- Waste Mgmt. Use Tax	83	95	100	105
Subtotal	$(15,292)	$(15,335)	$(15,310)	$(15,305)
Environmental Fund				
- Waste Mgmt. Use Tax	$83	$95	$100	$105
Subtotal	$83	$95	$100	$105

Statutory Change? Yes __X__ No ____

If yes, statute(s) affected: M.S. 287.035, 287.21, 297E.02, 297H, 297I.40, 297G.03

____ New Activity ____Supplemental Funding ____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends changes to several dedicated and excise taxes:

- Decrease taconite production tax rate by 10 percent.
- Change the deed and mortgage registry taxes to a percentage calculation to even out payments.
- Exclude gross receipts from raffle and paddlewheel games from the net tax and reducing the net tax on bingo.
- Subject the gross receipts from paddlewheel and raffle games to the combined receipts tax and raising each of the brackets by $200,000.
- Subject insurance premium taxes to quarterly payments.
- Repeal the 1 cent per bottle tax on distilled spirits and wine.
- Repeal the automobile self-insurance tax.
- Impose solid waste management use tax on commercial generators, residential generators, and self-haulers.

RATIONALE:

The department administers several dedicated and excise taxes, often referred to as "special taxes." During tax reform public meetings and meetings with stakeholder groups, several changes were recommended to simplify and reduce these taxes and to address issues of fairness and competitiveness. The Governor is recommending the following changes:

- Reduce the taconite production tax rate and make other changes in the corporate franchise tax to provide much needed tax relief to Minnesota's taconite producers. The production tax reduction will approximate the property tax reduction for commercial/industrial due to the general education levy takeover.
- Change the mortgage registry and deed tax calculations to a percentage to simplify tax calculations for taxpayers and for tax administrators.
- Remove raffles and paddlewheels from the net receipts tax and subject them to the combined receipts tax. This will reduce the number of organizations remitting small checks each month. Subjecting those games to the combined receipts tax will prevent organizations from converting pull-tabs or tipboards to those types of game to escape the combined receipts tax. Bingo is the most expensive form of lawful gambling to conduct. It makes sense to reduce the tax rate on this form of lawful gambling.
- Adjust the brackets of combined receipts tax paid on gross receipts from pull-tabs and tipboards. The combined receipts tax was enacted in October 1989. Since then the brackets have remained unchanged. In the early 1990s, approximately one-third of all charitable gambling organizations had a combined receipts tax liability while today more than half have this liability. This proposal provides most relief to mid-size organizations and reduces "bracket creep" that has occurred in this tax.
- Change scheduled insurance premium tax payments so that they are made on a quarterly basis, and also spread out declarations of estimated tax to conform to the schedules typical of other taxes requiring such declarations. Current law requires three annual declarations, two of them within 60 days of each other.
- During the department's reform meetings, some companies expressed a desire for change as a way to simplify filing of taxes owed. Not only are the dates odd, but quarterly payments would afford them better cash

Agency: Revenue, Department of (DOR)

Item Title: Special Taxes Reform and Relief

management. In the year of implementation, this would shift revenue forward but not reduce state tax collections overall.

- Repeal Minnesota's one-cent bottle tax, a relic from days of certification stamps for spirits and wine. Containers of distilled spirits and wine 200 milliliters and larger are taxed at one cent each. Calculating the tax is a nuisance for taxpayers and tax administrators and raises only a minor percentage of tax collected on spirits and wine.
- Repeal the automobile self-insurance tax, which raises little revenue but still requires a special administrative process. Coupled with other taxes on rental cars, this tax became an issue when a major rental car company was considering locating their national headquarters here. Because automobile insurance premium taxes are deposited in the excess police state-aid holding account, it is anticipated that repealing this tax will reduce amortization aid payments by one-half the collection amount.
- Impose a solid waste management use tax on commercial generators, residential generators, and self-haulers in situations where the solid waste management tax has not been billed or received by waste management service providers. The solid waste management tax, popularly known as the generator tax, is imposed on the generation of waste, and the waste management service providers are conduits for the collection of this tax. This proposal will cover situations where the waste is transported out-of-state and the service provider is not collecting the tax. It will be particularly useful in the case of self-haulers who take their garbage out-of-state for disposal where the tax cannot reach them, since the disposal service originates out-of-state.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

Programming and system modification associated with lawful gambling and insurance taxes require one-time administrative expenditures of $165 thousand in FY 2002. The balance of the administrative costs reflected on this page are for additional staff in investigation, tax research, and legal and appeals for revocation hearings.

FINANCING:

These changes will result in a decrease of General Fund revenues of approximately $15.2 million per year.

OUTCOMES:

The recommended changes simplify and reduce several dedicated and excise taxes to address issues of fairness and competitiveness.

- The taconite production tax rate will be reduced in a way that approximates the statewide reduction in commercial/industrial general education levy.
- Mortgage registry and deed tax calculations will be simpler.
- The number of organizations remitting small checks each month for raffle and paddlewheel games will be reduced.
- Organizations will be prevented from converting pull-tabs or tipboards to those types of game to escape the combined receipts tax.
- The tax on Bingo will be reduced.
- Adjusting the brackets for combined receipts tax paid on gross receipts for pull-tabs and tipboards will provide relief to mid-size organizations and reduce "bracket creep" that has occurred in this tax.
- Payments of the insurance premium taxes will conform to the schedules typical of other taxes.
- Repealing the automobile self-insurance tax and the 1 cent bottle tax will simplify the tax system with only minor impacts on state revenues.
- Extending the solid waste management use tax will increase the fairness of the tax.

Agency: Revenue, Department of (DOR)

Item Title: Petroleum Taxes

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
Highway User Fund				
- State Operations	$140	$-0-	$-0-	$-0-
Subtotal	$140	$-0-	$-0-	$-0-
Revenues: ($000s)				
General Fund				
- Petroleum Product Fee	$300	$300	$300	$300
Subtotal	$300	$300	$300	$300
Highway User Fund				
- Shrinkage Allowance	$2,500	$2,540	$2,590	$2,640
Subtotal	$2,500	$2,540	$2,590	$2,640

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 239.101, 296A.15, 296A.16

_____ New Activity ______Supplemental Funding ______Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends the following changes to the Petroleum Tax:

- Adjust the shrinkage allowance from 3 percent to 2.5 percent.
- Repeal the up-front exemption for farmers' gasoline purchases.
- Impose the inspection fee on the first licensed distributor receiving the petroleum products in Minnesota.

RATIONALE:

Minnesota law contains an antiquated provision to provide a shrinkage allowance in the transportation of petroleum products. The current shrinkage allowance is 3%. Because the actual shrinkage of the product is much less, and because the allowance used by most other states is less, the Governor proposes reducing the allowance to 2.5%. The allowances of other states that collect tax at the same place in the distribution chain as Minnesota are at least 2.5%. States that allow a lower allowance collect the tax from the owner of the product in terminal storage, which is one level higher in the distribution chain than where Minnesota collects the tax. One-third of the percentage collected will continue to be passed on to the dealers, as is current practice.

This proposal would also repeal the up-front tax exemption for gasoline sold for on-farm bulk storage. Farmers are the only group allowed to purchase gasoline exempt from motor fuel tax. Even in largely agricultural states like Iowa, farmers are not allowed to purchase gasoline exempt from fuel tax. In addition, little of today's modern farming equipment uses gasoline (most use diesel), and it has been many years since the last gasoline tractor has been manufactured. Farmers would still be able to apply for a refund for off-road gasoline usage, just like other businesses.

The last element of this initiative would create a level playing field for all petroleum products. Currently, the inspection fee is imposed on the petroleum product held in storage and sold or withdrawn from that storage in Minnesota. However, the same fee is not paid on product originating in other states but delivered in Minnesota. By imposing the fee on the first distributor, we are imposing it on receipt in Minnesota, regardless of where the shipment comes from.

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

The department is requesting $140,000 in FY 2002 to implement one-time programming modifications necessary to accommodate these policy changes.

OUTCOMES:

- Adjusting the state's shrinkage allowance will reflect modern business practice, put Minnesota in parity with surrounding states, and increase revenues to the highway user fund.
- Repealing the up-front exemption for gasoline purchased for farm use will decrease non-compliance with the petroleum tax laws.
- Changing the imposition point for the inspection fee will reduce an inequity for Minnesota terminals and will increase General Fund revenues by approximately $300 thousand by imposing the fee on all petroleum products, including those coming into Minnesota from other states.

Agency: Revenue, Department of (DOR)

Item Title: Health Care, Cigarette and Tobacco Tax Reform

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
Health Care Access Fund				
- State Operations	$3	$(27)	$(27)	$(27)
Subtotal	$3	$(27)	$(27)	$(27)
Revenues: ($000s)				
General Fund				
- Transfer Cigarette Tax	$-0-	$-0-	$(141,300)	$(141,300)
Subtotal	$-0-	$-0-	$(141,300)	$(141,300)
Health Care Access Fund				
- Transfer Cigarette Tax	$-0-	$-0-	$141,300	$141,300
- Repeal Premium Tax	-0-	(17,594)	(33,727)	(35,144)
- Perm Reduce MNCare	(28,000)	(59,000)	(62,000)	(64,000)
- Wholesale Drug	(16,000)	(34,000)	(35,000)	(37,000)
- Drug Deductions	4,000	10,000	11,000	12,000
- Adult Day Care Centers	(300)	(380)	(400)	(420)
Subtotal	$(40,300)	$(100,974)	$21,173	$16,736

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 295.50

_____ New Activity ______Supplemental Funding _____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends several changes to the health care taxes:

- Repeal the 1% premium tax imposed on nonprofit health plans;
- Repeal the wholesale drug tax;
- Freeze the MinnesotaCare hospital, surgical center and provider tax rate at 1.5%;
- Deposit 85% of cigarette tax collections into the Health Care Access Fund (HCAF) beginning in FY 2004; and
- Exempt adult day care centers from definition of health care provider.

In addition, the Governor recommends eliminating the HCAF Federal Contingency reserve and replaces it with a new reserve based on fund activity. Related expenditure recommendations can be found in the health and human services, and commerce budgets. These include changes to the MinnesotaCare program which increase health services for children and lower HCAF expenditures, and one-time funding for the Minnesota Comprehensive Health Association, safety-net providers, and a new Minnesota Center for Health Quality.

RATIONALE:

The Governor is recommending retention of the MinnesotaCare tax with modifications to simplify compliance and administration, create stability in the fund and to promote public health outcomes.

The current MinnesotaCare and insurance premium tax contain several structural problems that create uncertainty for taxpayers. The legislature has reduced the tax rate to 1.5%, but it is scheduled to return to 2% in 2002. The one-percent premium tax on nonprofit health plans is scheduled to be re-imposed in 2003. Acknowledging that the legislature can adjust tax rates, taxpayers nonetheless should be able to plan without the uncertainty caused by statutory rate triggers.

The Governor is recommending that the premium tax on nonprofits plans, which falls on a narrow segment of the health care economy, be repealed. The Governor is also recommending that the provider tax rate be fixed at 1.5% to prevent the tax from increasing in the future. Contingent rates and annual deferrals of rate changes make planning difficult for taxpayers.

The Governor is also recommending repeal of the wholesale drug tax. The wholesale drug tax is subject to increasing avoidance as consumers increase purchases prescription drugs from sources outside Minnesota. Use tax compliance for this particular tax is virtually nonexistent. For hospitals, surgery centers and other providers, calculating the limitations to the deduction for drug purchases is complicated and controversial. Knowing with any certainty which wholesalers are subject to the tax is also a complication for those taking the deduction.

To offset the revenue impact of the above changes on the Health Care Access Fund, Governor's recommends dedicating a portion of existing cigarette tax to the Health Care Access Fund beginning in FY 2004.

Adult day care centers that employ a licensed health care provider (generally, a licensed practical nurse who is the center director or an employee who is responsible for medication assistance) are required to register and pay the tax, if applicable. Other similar facilities such as adult foster homes and day training and habilitation services are already exempt. The recommendation exempts adult day care centers from the definition of a health care provide for gross revenues received on or after January 1, 2002.

Agency: Revenue, Department of (DOR)

Item Title: Health Care, Cigarette and Tobacco Tax Reform

IMPLEMENTATION AND ADMINISTRATIVE COSTS:

The department expects to incur increased programming and system modification cost of about $30,000 in FY 2002. However, $27,000 in administrative cost reductions are expected in FY 2002 and future years. Savings are expected to result primarily from reduced staff and equipment involved in administering the wholesale drug distributor tax.

FINANCING:

In FY 2002-03, the cigarette excise tax deposits continue as under current law, and the health care access fund will spend down its surplus. Beginning in fiscal 2004, 85% of cigarette excise tax revenues will be directed to the HCAF. The estimated amounts are $141 million in both FY 2004 and FY 2005. Those amounts offset estimated reductions of $119.7 million and $124.1 million in current HCAF revenue sources in FY 2004 and FY 2005.

These tax changes are coordinated with the elimination of the $150 million Federal Contingency Reserve in the HCAF. A smaller reserve is recommended at a level equal to 20% of direct MinnesotaCare appropriations. This change frees roughly $100 million in reserves by FY 2005.

OUTCOMES:

Health care taxation is intricately interwoven with health policy, and some elements of the tax law, while contrary to general tax policy, promote other public policy goals. For example, the provider tax and the programs it supports have been shown to reduce the burden of uncompensated care.

While work still needs to be done on the expenditure side of the Health Care Access fund, bringing stability to the revenue stream is an integral part of reforming health care taxes. Fixed rates, that are predictable for taxpayers, promote stability and predictability in the tax.

The repeal of the premium tax reduces an inequity in health care taxation. The tax falls on a relatively narrow segment of the health care economy and produces a result where similar services receive different tax treatment, depending on the source of payment.

Repealing the wholesale drug tax removes an unenforceable provision in law and simplifies compliance for taxpayers. Hospitals that markup the price of prescription drugs to patients will not have to calculate a deduction for their acquisition costs. The department will not have to audit the deduction or assist taxpayers to comply. The tax will not become embedded in the price of drugs sold at pharmacies thus offering the possibility of relief to purchasers.

Agency: **Revenue, Department of (DOR)**

Item Title: **Reduction of the Motor Vehicle Registration Tax**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- Repeal Exist Appr	$(161,723)	$-0-	$-0-	$-0-
Subtotal	$(161,723)	$-0-	$-0-	$-0-
Revenues: ($000s)				
General Fund				
- New Ded. of MVST	$(202,723)	$(85,000)	$(120,000)	$(156,000)
Subtotal	$(202,723)	$(85,000)	$(120,000)	$(156,000)
Highway User Fund				
- Repeal Existing Appr	$(161,723)			
- New Tax Reduction	(41,000)	$(85,000)	$(120,000)	$(156,000)
- Receipt from MVST	202,723	85,000	120,000	156,000
Subtotal	$-0-	$-0-	$-0-	$-0-

Statutory Change? Yes __X__ No ____

If yes, statute(s) affected: 168.013, subdivision 1 and 297B.09, subdivision 1

____ New Activity __X__ Supplemental Funding ____ Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends a reduction in the motor vehicle registration tax for passenger vehicles effective for renewals after December 31, 2001.

Initially, registration taxes will be capped at a maximum of $189 in the first year and capped at $89 each following year. On January 1, 2004, the maximum would be $75 in every year.

RATIONALE:

Currently the registration tax is based on a combination of value and age, subject to a minimum tax of $35 and a maximum tax of $189 for the first annual renewal period and $99 for each subsequent renewal period. These rates are higher than the rates imposed by some of our neighboring states.

This proposal retains the current rate structure based on value and age, the current depreciation schedule and minimum rate of $35, but sets a maximum of $189 for the registration of new vehicles and $89 for every registration year following the initial year. The maximum is ultimately reduced to $75 on January 1, 2004.

Estimated receipts in the Highway User Tax Distribution Fund (HUTDF) are reduced by this proposal. However, an increase of the amount of the sales tax on motor vehicles dedicated to the HUTD Fund, beginning with revenues collected on July 1, 2001, offsets HUTD Fund reduced revenues.

FINANCING:

As part of this proposal, the Governor recommends increasing the percentage of the motor vehicle sales tax dedicated to Highway User Tax Distribution Fund, currently at 32%, in FY 2003 and each following year so the Highway Fund is held harmless for this tax change. In addition, the Governor recommends repealing the $161.723 million General Fund appropriation to the Highway Fund that was to occur under statute in FY 2002, and beginning the dedication of a portion of the motor vehicle sales tax one year earlier.

The Governor recommends statutory dedication of motor vehicle sales tax revenues to the HUTDF according to the following schedules (based on an anticipated 6% motor vehicle sales tax rate).

FY 2002 – 39% est. $202.7 million
FY 2003 – 50% est. $278.4 million
FY 2004 – 55% est. $319.2 million
FY 2005 – 61% est. $316.2 million

These percentages will cover both the HUTDF shortfall due to additional registration tax reduction and impact of reducing the sales tax rate.

OUTCOMES:

The reduction in tax rates will make Minnesota's motor vehicle registration tax more competitive with surrounding states.

State income tax revenues will increase a small amount because vehicle owners who itemize deductions will deduct less motor vehicle registration tax paid. These changes are shown as an offset on the income tax reform and relief budget page.

Agency: **Revenue, Department of (DOR)**

Item Title: **Tax Refund Interest**

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
- Tax Refund Interest	$-0-	$(5,000)	$(5,000)	$(10,000)
Subtotal	$-0-	$(5,000)	$(5,000)	$(10,000)
Revenues: ($000s)				
General Fund				

Statutory Change? Yes ______ No __X__

If yes, statute(s) affected: M.S. 270.76

_____ New Activity ______Supplemental Funding _____Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends reducing the forecast of the open appropriation for Tax Refund Interest payments by $5 million in FY 2003 and FY 2004 and by $10 million in FY 2005

RATIONALE:

The forecast for tax refund interest payments has been growing steadily for the last several years. It has grown from a $9.2 million expenditure item in FY 1997 to a $34.8 million expenditure item in FY 2000. A small amount of this growth comes from delays in processing tax filings and tax refunds as the system handles more taxpayers and more complicated filings. Most of the growth in tax refund interest payments, however, has come as a result of interest due after audit or court settlements in the corporate franchise and sales tax area. Some of the growth is directly traceable to several large court cases, and some of the growth is more generally attributable to aggressive corporations challenging what they think is a complicated and unfair tax system.

Taken in total, the Governor's tax relief and reform proposal provides a great deal of tax simplification. Examples of this include:

- repealing several specific taxes;
- changing complicated refunds to up-front exemptions;
- broadening capital equipment definitions;
- standardizing definitions;
- modifying penalty provision;
- maximizing federal conformity; and
- changing complicated administrative procedures (e.g. June accelerated sales tax payments).

Likewise, the Governor's tax package has created a great deal of net tax relief for individuals and businesses alike.

Major simplification and generally lower tax liability should have a positive effect on future expenditures for tax refund interest. Simpler laws, simpler procedures and lower rates should ultimately translate into faster processing, more voluntary compliance, fewer contested audits, and fewer contested cases. This should then translate into reduced expenditure for tax refund interest.

FINANCING:

The appropriation for Tax Refund Interest payments comes from the General Fund. All saving in this area will accrue to the general fund.

OUTCOMES:

Less General Fund money being spent for interest on tax refunds.

Agency: Revenue, Department of (DOR)

Item Title: Expand Political Contribution Refund

	2002-03 Biennium		2004-05 Biennium	
	FY 2002	FY 2003	FY 2004	FY 2005
Expenditures: ($000s)				
General Fund				
- Political Cont. Refunds		$4,600	$4,600	$4,600
Subtotal		$4,600	$4,600	$4,600
Revenues: ($000s)				
General Fund				

Statutory Change? Yes __X__ No ______

If yes, statute(s) affected: M.S. 290.06, Subd 23

______ New Activity ______Supplemental Funding ______Reallocation

GOVERNOR'S RECOMMENDATION:

The Governor recommends that starting in FY 2003, the maximum political contribution refund be doubled from $50 per individual to $100 per individual.

RATIONALE:

The Governor has recommended a two-prong proposal to increase accountability in the political system. The goal of this proposal is to offer the incentive of increased funding in exchange for greater accountability for campaign spending. The first prong, proposed here, is the doubling of the political contribution refund (PCR) program. This increase will allow individuals to contribute up to $100 to a state candidate, political party, or legislative caucus and receive a full refund from the state.

The PCR program is funded through an open appropriation that is administered by the Department of Revenue. The estimated cost of this increase is $4.6 million per year.

The second prong, proposed elsewhere, seeks to prohibit independent expenditures by political parties between the primary and general elections, and restrict multi-candidate expenditures by parties through the reduction of the number of categories that qualify as multi-party expenditures. The expectation is that political parties and legislative caucuses will voluntarily agree to restrict independent expenditures in exchange for accepting public funds.

FINANCING:

The refund is paid out of a General Fund open appropriation.

OUTCOMES:

This proposal will result in increased accountability in campaign finance. This increased accountability will lead to greater citizen involvement. Candidates will have access to greater public campaign financing.

Related Governor's Budget Initiatives

Initiatives in other parts of the Governor's budget that are parallel to or may affect provision in the Tax Relief and Reform packages.

Item: **General Education Funding Reform**
Agency: **Children, Families and Learning**
Budget Book: **Children, Families and Learning**

Discusses several education financing changes, some of which are directly related to the Governor's tax reform package and the state assumption of the general education levy.

Item: **Child Care Consolidation**
Agency: **Children, Families and Learning**
Budget Book: **Children, Families and Learning**

Increases spending on existing child care activities using the savings from repeal of the current dependent care tax credit.

Item: **Children's Family Foster Care**
Agency: **Human Services**
Budget Book: **Health and Human Services**

Provides state funding sufficient to assume mandated foster care costs prior to permanent placement decisions. Funding comes from a reduction in county HACA aid.

Item: **Twin Cities Rise**
Agency: **Trade and Economic Development**
Budget Book: **Economic Development**

Provides appropriation necessary to change the Twin City Rise job training and retention program from a tax credit based program to an appropriation based program located with other job training programs.

Item: **PCA Environmental Tax Reform**
Agency: **Pollution Control Agency**
Budget Book: **Environment**

Reduces a number of environmental fees and restructures the environmental funds to allow more flexibility in directing money to the highest environmental priorities.

Item: **Telecommunications Reform**
Agency: **Commerce**
Budget Book: **Economic Development**

Changes fees and taxes on telecommunications with the goal of encouraging more competition and providing statewide access to all telecommunication and cable services currently available.

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County Criminal Justice Aid

Revenue Source: State General Fund
M.S. 477A.0121; 477A.03

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$29,356	$30,490	$31,352	$32, 159	$33,001
Recommendation	$29,356	$30,490	$31,352	$32, 159	$33,001
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this state aid is to reduce the reliance of criminal justice and corrections programs on local property taxes.

County criminal justice aid is distributed to each county based on population and number of "Part I" crimes reported by the commissioner of public safety. Each year, 1.5% of the total appropriation is reserved for state payments for public defender costs. This aid program began in FY 1994. Transfers from HACA of $10 million for FY 1997 and $6.8 million for FY 1998 have increased the level significantly. The aid is adjusted for inflation annually.

The forecast of this aid is based on appropriations and an estimate of the implicit price deflator for state and local government purchases of goods and services provided by Data Resources, Inc.

__Governor's Recommendation__:

The Governor recommends no changes in this aid program.

Disparity Reduction Credit Aid ("Border City Disparity Aid")

Revenue Source: State General Fund
M.S. 273.1398, Subd. 4; Laws 1998, Reg. Sess., Ch. 389, Art. 2, Sec. 17

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$4,755	$5,080	$5,338	$5,605	$5,885
Recommendation	$4,755	$5.080	$2,962	$3,059	$3,262
Change	$-0-	$-0-	($2,376)	($2,546)	($2,623)

The purpose of this state aid is to provide a property tax credit for apartment and commercial/industrial property in the border cities of Breckenridge, Dilworth, East Grand Forks, and Moorhead.

First paid for taxes payable year 1989, the credit reduces property tax burden for commercial/industrial, public utility and apartment property to 2.3% of taxable market value. The credit declined from $5.4 million in FY 1998 to $4.3 million in FY 1999 because legislation reduced the class rates of eligible property and increased aids.

The Department of Revenue estimates the cost of disparity reduction credit by modeling the interaction of gross and net taxes, inflation in market values, changes in local tax rates, and other adjustments at the unique taxing jurisdiction level. A 1998 law change reduced the effective tax rate for class 3a property from 3.3% to 2.3% thus increasing the credit effective for FY 2000.

__Governor's Recommendation__:

The Governor recommends a reduction in this state aid as a part of the overall property tax reform initiative. (See Property Tax Aids Reform change item page for further explanation.

Property Tax Refund

Revenue Source: State General Fund
M.S. 290A; Laws 1998, Reg. Sess., Ch. 389, Art. 2, Sec. 18-19

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$186,819	$194,576	$202,135	$208,476	$214,142
Recommendation	$186,819	$194,576	$208,835	$215,876	$223,442
Change	$-0-	$-0-	$6,700	$7,400	$9,300

The purpose of this refund is to provide general property tax relief to homeowners and renters based on an income definition of ability to pay.

The property tax refund program is designed to "target" state paid financial assistance to households that have relatively high property taxes and low income. In addition to the regular refunds provided to homeowners and renters, the legislature will periodically provide additional "targeting" refunds to specified property owners who may be uniquely impacted by high property taxes due to certain economic conditions or other related state property tax policies.

The property tax refund for homeowners is currently underutilized. This type of program is far more efficient than other state aid policies in "targeting" property tax relief to households who need it. The targeting refund is an important property tax relief mechanism especially during periods when other major state property tax law changes are being implemented.

The Department of Revenue estimates PTR costs by modeling growth in state personal income, change in the number of applicants, changes in property taxes on homesteads, growth in rent paid by rental households, and changes to the property tax refund schedule, including indexing income brackets and maximum refund amounts for annual inflation.

Governor's Recommendation:

The Governor recommends increasing this program and making it more sensitive to income as a part of the overall property tax reform initiative. (See Property Tax Reform and Relief change item page for further explanation.

Low Income Housing Aid

Revenue Source: State General Fund
1998, Reg. Sess., Ch. 389, Art. 4, Sec. 10, 11

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$559	$1,604	$1,604	$1,712	$428
Recommendation	$559	$1,604	$1,674	$1,818	$568
Change	$-0-	$-0-	$70	$1,106	$140

The purpose of this state aid is to help cities that sustain a loss of tax capacity of 2 1/2% or more from conversion of apartments to the new class 4d, or cities that have new construction of apartment classified as 4d after 1-1-99.

The existing housing aid, for cities that sustain more than a 2 1/2% reduction in net tax capacity as a result of conversion of existing apartments to the new class 4d, is equal to the loss of tax base times the city government's average tax rate for taxes payable in 1998.

The new construction aid is equal to 1.5 times the tax capacity of qualified new construction of class 4d rental property times the city government's average tax rate for the previous year. The existing aid will be paid in FY 1999 to FY 2002, and the new construction aid will be paid beginning in FY 2002.

The aid began in FY 2000.

The existing low income housing aid was estimated with preliminary data from the Minnesota Housing Finance Agency.

Governor's Recommendation:

The Governor recommends a small increase in this aid program with all new funds being directed to new construction of low income housing. See the Property tax Aid reform change item page for more information.

Educ Homestead and Educ Agricultural Credit Aid

Revenue Source: State General Fund
M.S. 273.1382; Laws 1998, Reg. Sess., Ch. 389, Art. 2, Sec. 13, 14

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$387,192	$396,299	$399,823	$403,825	$407,863
Recommendation	$387,192	$396,299	$-0-	$-0-	$-0-
Change	$-0-	$-0-	($399,823)	($403,825)	($407,863)

The purpose of this aid is to provide school levy property tax relief to homeowners to offset the tax shift caused by reduction in commercial/industrial class rates.

The education homestead credit was established beginning in pay 1998 to reduce the property tax burden of homestead owners. The credit in pay 1998 is equal to 32% of the general education tax up to a $225 maximum. It has increased over time. The credit will change in pay 2000 and following years to 64.1% of general education tax up to $335. The credit offsets the initial tax shift caused by reduction of commercial/industrial class rates. In 1999, a similar credit with different limits was created for agricultural property

The credit protects homesteads and agricultural property from initial tax shifts due to changes in the property classification system, and does not subsidize programs and service costs determined locally.

The Department of Revenue estimates education homestead costs for real property using a file of all homestead parcels in the state, together with its property tax computer simulation model for all property types. Allowance is made in the estimate for growth of homestead market value and number of homesteads. The manufactured home portion of the education credit is estimated using abstract of tax lists data

Governor's Recommendation:

Because the state will be assuming the local costs associated with the general education level, this credit is no longer necessary. The Governor recommends eliminating these aids. See the Property tax Reform and Relief Change item page for more information,

Market Value Credit Aid

Revenue Source: State General Fund
New

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$-0-	$-0-	$-0-	$-0-	$-0-
Recommendation	$-0-	$-0-	$383,325	$404,097	$416,220
Change	$-0-	$-0-	$383,325	$404,097	$416,220

In order to continue the state's policy of lower relative tax burdens for low valued homes, two new credits should be created to replace the Education Homestead and Education Agricultural Credits.

The new credits will provide property tax relief to residential homesteads and farm homestead land based on taxable market value. For residential homesteads, the credit equals 0.0050 times taxable market value up to a maximum of $330. The credit cannot reduce a residential homesteads tax rate below 0.85% of market value. For farm homestead land, the credit is equal to 0.0025 times taxable market value up to a maximum of $288.

The local revenue impacts of both credits will be offset for local governments with a new market value aid program.

Governor's Recommendation:

The Governor recommends creation of a new market value based property tax credit for homesteads and agricultural homesteads, along with a corresponding aid program. See the Property tax Reform and Relief Change item page for more information.

Enterprise Zone Credit Aid

Revenue Source: State General Fund
M.S. 469.171, Subd. 7a; Laws 1998, Reg. Sess., Ch. 389, Art. 12, Sec. 10,Subd. 3

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$5	$4	$4	$4	$4
Recommendation	$5	$4	$4	$4	$4
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to offset local costs of a property tax credit for businesses in designated enterprise zones to encourage business development and retention in distressed areas.

Businesses in enterprise zones receive state-paid property tax credits at the option of the business and municipal government. The credit reduces the property tax bill of the business, and the state reimburses the local governments affected. Currently, the credit is provided only in the city of Breckenridge.

The credit is assumed to remain constant at the FY 1999 level. Although a $500,000 additional allocation for enterprise zones was passed in 1998, use of it for property tax reduction is uncertain.

Governor's Recommendation:

The Governor recommends no change in this credit and aid program.

Disaster Credit Aid

Revenue Source: State General Fund
M.S. 273.123, Subd. 1-6

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$22	$144	$-0-	$-0-	$-0-
Recommendation	$22	$144	$-0-	$-0-	$-0-
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to offset local costs of a property tax credit for homestead property damaged by a disaster.

Disaster credit reduces the property tax of homestead property in the following payable year after damage suffered within a declared disaster or emergency area. The property is reassessed after the damage, and the difference between the original and reassessed value is multiplied by the ratio of the number of full months remaining in the year divided by 12 months. This product is then multiplied by the prevailing local tax rate to obtain the credit amount. The state reimburses local governments for the credit. The credit program first became effective in pay 1984.

Data on storm damage from the Department of Public Safety is used to estimate market value reductions, and projected tax rates from the Department of Revenue's property tax model are used to calculate the estimated credit.

Governor's Recommendation:

The Governor recommends no change in this credit and aid program.

Supplementary Property Tax Relief and Taconite Aid Reimbursement

Revenue Source: State General Fund
M.S. 273.1391; Laws 1998, Reg. Sess., Ch. 389, Art. 10, Sec. 3; M.S. 477A.15

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$548	$564	$589	$624	$661
Recommendation	$548	$564	$589	$624	$661
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to provide property tax relief similar to the taconite homestead credit for school districts that do not meet the eligibility requirements as a taconite tax relief area but are located in a county where taconite is mined or quarried (supplementary relief), or school districts that received occupation tax proceeds prior to a law change in 1978 (taconite aid reimbursement).

Supplementary property tax relief ("supplemental taconite homestead credit") is provided to school district #317 in Itasca County and to school district #698 in Aitkin and St. Louis counties. The credit has the same formula as the "57%" taconite homestead credit program, but is paid from the state General Fund. The qualifying homestead tax is first reduced by the education homestead credit before computing this credit.

The supplementary homestead tax relief (or supplemental taconite homestead credit) was changed in the 1998 session to remove a maximum credit provision, increasing the FY 2000 expenditure. Taconite aid reimbursement is a constant amount each year. The credit and reimbursement is assumed to remain level from FY 2000 to FY 2003.

Governor's Recommendation:

The Governor recommends no change in this credit and aid program.

Homestead and Agricultural Credit Aid (HACA)

Revenue Source: State General Fund
M.S. 273.1398; Laws 1998, Reg. Sess., Ch. 389, Art. 2, Sec. 15

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$501,621	$488,972	$486,717	$486,804	$490,309
Recommendation	$501,621	$488,972	$135,360	$136,833	$142,174
Change	$-0-	$-0-	($351,357)	($349,971)	($348,135)

The purpose of this aid is to provide general property tax relief to local governments to compensate for a reduction in taxable value class rates on homesteads, rental, commercial/ industrial, and other properties.

The intent of HACA was to replace the homestead and agricultural credit property tax relief system with a general aid that compensates local governments for loss in tax capacity resulting from lower class rates on selected property types. The homestead and agricultural credit aid was adopted in 1988 with the first effective year being for taxes payable in 1990. In 1991 and subsequent years, the allocation of aid amounts to local governments was frozen, but increased annually by various adjustments. Under current law, reductions in class rates may result in increased HACA if specified in law, though this adjustment is not automatic. The final aid amounts distributed to local governments are also subject to program offsets for state takeover of income maintenance and court costs.

HACA is a general aid that is not well targeted to "needy" communities nor well targeted to individuals with little ability to pay. In general, this aid mechanism has made local governments dependent on state revenue and is inefficient in targeting property tax relief to needy individuals.

Governor's Recommendation:

The Governor recommends substantially reducing this aid program. See Property Tax Aid Reform change item page for additional information.

Local Government Aid (LGA)

Revenue Source: State General Fund
M.S. 477A.013 - .015; Laws 1998, Reg. Sess., Ch. 389, Art. 4, Sec. 8, 9, 12, 13

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$395,025	$411,831	$422,196	$433,168	$446,260
Recommendation	$395,025	$411,831	$490,439	$510,346	$531,300
Change	$-0-	$-0-	$68,243	$77,178	$85,000

The purpose of this aid is to provide general support and property tax relief to local governments.

The formula for cities has changed many times since enacted in 1971. In general, the formula attempts to target aid to those cities with the lowest tax capacity and highest need, but provides for a substantial "grandfathered" amount. Under current law for taxes payable in 1999 and subsequent years the formula is:

- Need increase percentage * (city revenue need times 1997 population) minus (city net tax capacity times tax effort rate).
- Total City LGA is increased annually for inflation.
- Township aid is grand-fathered from the 1993 level, with annual increases for inflation.

The primary policy issues are determining the appropriate level of "general support" aid to local governments and how to best "target" that aid to communities with higher need and low wealth.

Dollar amounts are appropriated by law.

Governor's Recommendation:

The Governor recommends eliminating the old Local Government Aid programs and replacing it with a larger program, with a new distribution formula based on more on need and capacity. See the Property Tax Aid Reform change item page for more information.

Manufactured Home Homestead and Agricultural Credit Aid

Revenue Source: State General Fund
M.S. 273.166

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$8,195	$8,237	$8,279	$8,316	$8,362
Recommendation	$8,195	$8,237	$8,279	$8,316	$8,362
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to provide general property tax relief to local governments to compensate for a reduction in taxable value class rates affecting manufactured homes.

The homestead and agricultural credit aid (HACA) for manufactured homes was adopted in 1988 with the first effective year being for taxes payable in 1990. Originally, the aid was determined by a formula that computed the difference between "gross tax capacity" and "net tax capacity." In 1991 and subsequent years the allocation of aid was frozen, but increased annually by various adjustments. Unlike HACA for real property, the formula for manufactured home HACA specifies that any class rate change requires a "net tax capacity adjustment" and thus provides for an "automatic" response to class rate changes.

The FY 2000 estimate assumed the same additional adjustment for class rate changes as the FY 1999 amount. Household growth adjustments to county manufactured home HACA for FY 2000-2003 were assumed to be at the same level as in FY 1999.

Governor's Recommendation:

The Governor recommends eliminating this aid program as part of the overall property tax reform initiative. See the Property Tax Aid Reform change item page for more information.

Police and Fire State Aids

Revenue Source: State General Fund
M.S. 69.011; 69.021; 69.54-69.56; 69.021, Subd. 11e; 423A.02, Subd. 1-1b

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$66,511	$74,019	$76,992	$80,081	$83,287
Recommendation	$66,511	$73,969	$76,872	$80,031	$83,237
Change	$-0-	($50)	($50)	($50)	($50)

The purpose of this aid is to support pensions of local peace officers and firefighters. It includes Police Aid, Fire Aid, Police and Fire (P&F) Amortization Aid, P&F Additional Amortization Aid, and P&F Supplemental Amortization Aid.

The revenue for Police Aid is mainly from auto insurance premium tax. The available aid is limited to employers' actual pension obligation. Because the tax revenue usually exceeds employers' obligation, an "excess police state-aid holding account" is used to allocate the excess revenue to an ambulance service account, additional amortization aid, or the general fund.

The initial revenue source for Fire Aid is mainly from fire insurance premium tax. An additional amount of fire aid also is allocated from the annual appropriation for amortization aid.

P&F Amortization Aid is provided to police or salaried firefighters' pension associations that have an unfunded actuarial accrued liability. Certain reductions in aid to the Minneapolis association are made, depending in part on investment returns. P&F Supplementary Amortization aid of $1 million per year is also for police and fire associations with unfunded liabilities. P&F Additional Amortization Aid is allocated from the excess police aid account, and also is paid to police aid associations with unfunded liabilities. Some of these aids is also known as "supplemental benefit reimbursement." This is an aid for volunteer firefighter associations to fund a 10% benefit when volunteer firefighters receive a lump pension distribution.

Governor's Recommendation:

The Governor recommends no change to these programs, except of the small impact on amortization aids associated with the repeal of the automobile self-insurance tax.

Public Employees Retirement Association Aid

Revenue Source: State General Fund
M.S. 273.1385

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$14,565	$14,565	$14,565	$14,565	$14,565
Recommendation	$14,565	$14,565	$14,565	$14,565	$14,565
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to provide state funds to cities, counties, towns and other non-school jurisdictions to offset an employer contribution rate increase for the Public Employees Retirement Association (PERA) enacted in 1997.

The aid for eligible jurisdictions is equal to 0.35% of the FY 1997 payroll for employees who were members of the general plan of PERA. The first aid payment was in December 1998, and represented one-half of the annual aid for FY 1999 and following years. The aid for FY 2000 and following years for any jurisdiction cannot exceed the aid paid for FY 1999, but can be reduced if the PERA payroll of an employer is reduced below the FY 1997 level. The aid terminates on 6-30-2020.

The forecast of this aid is based on appropriations. The aid level is held constant from FY 1999 to FY 2003, assuming that the PERA payroll of employers will remain above the FY 1997 level.

Governor's Recommendation:

The Governor recommends no change in this aid program even though PERA is facing a substantial deficiency and will likely be seeking aid increases. The Governor believes any additional spending for local government aids must be clearly tied to shared state and local priorities.

Family Preservation Aid

Revenue Source: State General Fund
M.S. 477A.0122; 477A.03; Laws 1998, Reg. Sess., Ch. 389, Art. 2, Sec. 16, 20 and Art. 4, Sec. 8c

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$21,721	$22,645	$23,244	$23,843	$24,469
Recommendation	$21,721	$22,645	$33,244	$33,943	$34,690
Change	$-0-	$-0-	$10,000	$10,100	$10,201

The purpose of this aid is to provide state funds to counties to develop prevention programs and reduce the rate of increase in the costs of out-of-home placement of children and the related property tax increase.

This aid was allocated to counties in FY 1996 based on a county's share of out-of-home placement of children, and a county's share of income maintenance caseload. Thereafter, the aid was increased annually based on a county's share of the statewide income maintenance caseload. For FY 2001, the aid was increased by $20 million. The total appropriation is adjusted annually for inflation.

The 1998 legislative session mandated a study of family preservation aid, requiring recommendations for a new formula and study of proposals for reducing reporting mandates on out-of-home placement caseloads.

The forecast of this aid is based on appropriations and an estimate of the implicit price deflator for state and local government purchases of goods and services provided by Data Resources, Inc.

Governor's Recommendation:

The Governor recommends an increase of $10 million annually starting in FY 2003, to be offset by a county HACA reduction. See Property Tax Aid Reform change item page for additional information.

Attached Machinery Aid

Revenue Source: State General Fund
M.S. 273.138

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$3,218	$3,218	$3,218	$3,218	$3,218
Recommendation	$3,218	$3,218	$-0-	$-0-	$-0-
Change	$-0-	$-0-	($3,218)	($3,218)	($3,218)

The purpose of this aid is to compensate counties and school districts for lost revenue because of the removal of attached machinery from the tax base in 1973. The tax base previously included commercial/industrial machinery as taxable property.

The aid is a fixed amount, paid to counties beginning in 1984, based on the 1972 assessed value of attached machinery times the counties' total mill rate for 1983 times 1.25. The aid to schools is based on the 1972 assessed value times the 1973 mill rate for certain school levies, and the aid is subtracted from school levy limits. The aid is targeted to counties (except Hennepin, Ramsey and St. Louis) with an unusually high level of exempted machinery value in 1972

Only 13 counties qualify for the aid. The limited eligibility and dated basis suggests that a new look at the purpose of the aid is needed.

Governor's Recommendation:

The Governor recommends that this small and outdated aid be eliminated. See Property Tax Aid reform change item page for more information.

Indian Casino Aid (Payments to counties under tax refund agreements with Indians)

Revenue Source: State General Fund
M.S. 270.60, Subd. 4; Laws 1998, Ch. 389, Art. 16, Subd. 11

CURRENT LAW ($ 000's)	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$762	$762	$762	$762	$762
Recommendation	$762	$762	$762	$762	$762
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to provide state tax relief to counties containing an Indian reservation where the tribe operates a casino and has an agreement with the state to collect taxes.

If the total payment exceeds $1.1 million, reductions are made first to counties that do not have a per capita income less than 80% of the state level or have 30% or more of total market value of real property that is tax exempt. The aid is equal to 10% of the state share of taxes collected from the Indian reservation under a tax agreement, up to a maximum of $1.1 million per year. A total of 10 counties were paid for FY 1999.

The aid payments began in FY 1999.

It was assumed that the same set of 10 counties will continue to be eligible in future years, and that tax agreements will generate revenue for the state at the same level.

Governor's Recommendation:

The Governor recommends no change in this aid program.

TIF Deficit Aid

Revenue Source: State General Fund
Laws 1997, Reg. Sess., Ch. 231, Art. 1, Sec. 19

CURRENT LAW ($ 000's)	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$1,500	$3,139	$3,139	$-0-	$-0-
Recommendation	$1,500	$3,139	$68,739	$65,600	$65,600
Change	$-0-	$-0-	$65,600	$65,600	$65,600

The purpose of this aid is to provide state funds to municipalities for deficits in tax increment financing districts (TIF) caused by reductions in business property class rates for taxes payable in 1998.

A total of $2 million was appropriated in the 1997 legislative session to fund grants to tax increment financing districts for deficits caused by reductions in business property class rates for taxes payable 1998. The original appropriation was available for FY 2000 and FY 2001. In 1999 additional money was appropriated and the end date for use of the money was extended.

The aid began in FY 2000.

Governor's Recommendation:

The Governor is recommending a large increase in this aid programs associated with property tax changes in the tax reform package. He is also recommending elimination of current TIF penalties for cities. See the Property Tax Aid Reform change item page for additional information.

Senior Deferral Reimbursement

Revenue Source: State General Fund
M.S. 290B.09

CURRENT LAW ($ 000's)					
	FY 01	FY 02	FY 03	FY 04	FY 05
Forecast Base	$38	$70	$140	$280	$560
Recommendation	$38	$70	$140	$280	$560
Change	$-0-	$-0-	$-0-	$-0-	$-0-

The purpose of this aid is to provide state reimbursement to counties for property tax deferrals granted to qualified homeowners age 65 or older.

Passed in 1997 and effective for taxes payable in 1999 and following years, this reimbursement to counties begins in FY 2000. The reimbursement equals the property taxes deferred each year, less property tax refunds and revenue recapture.

The senior deferral program had about 10 applicants in 1998, and the first payment will be made in FY 2000. For 1999 (payment in FY 2001), it was assumed that participation will increased to about 100 applicants because the deferral will be announced on the PTR form.

Governor's Recommendation:

The Governor recommends no change in this aid program.