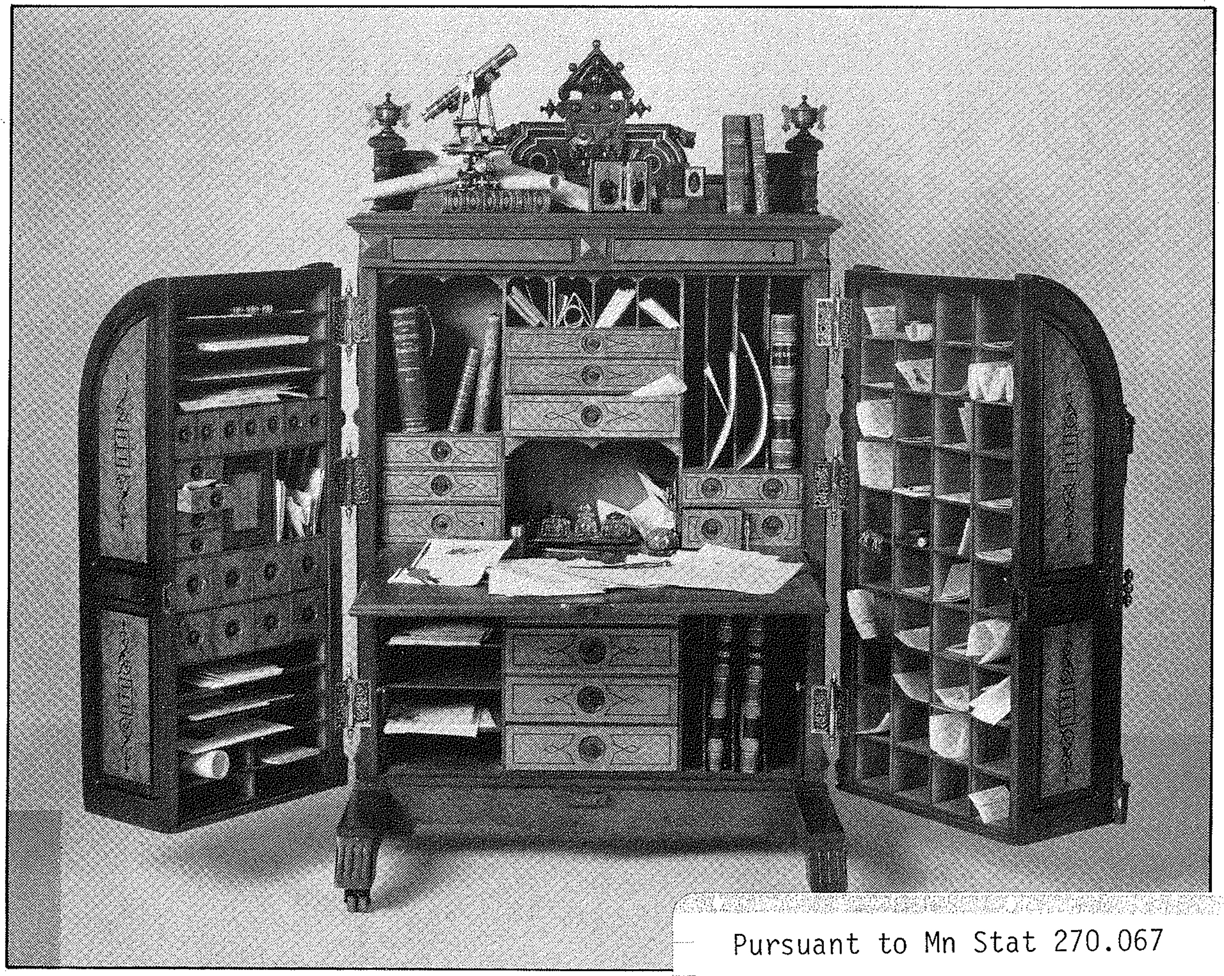
TAX EXPENDITURE BUDGET

STATE OF MINNESOTA

FISCAL YEARS 1984-1987



Pursuant to Mn Stat 270.067

ARY 1985
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A REPORT TO THE LEGISLATURE
PREPARED BY THE COMMISSIONER OF REVENUE
PURSUANT TO MINNESOTA STATUTES, 1983 SUPPLEMENT, SECTION 270.067

Cover: Extra Grade Wooton Cabinet Secretary, 1874-1880, one of seventeen Wooton patent desks on exhibit at the Minnesota Historical Society through June 3, 1985.

Photo Credit: The Oakland Museum and the Indiana State Museum.

February, 1985

To the Honorable Rudy Perpich, Governor, and the Legislature of the State of Minnesota:

This report is the first comprehensive inventory of the tax expenditure provisions of Minnesota tax law. It contains an estimate of the revenue impact of each tax expenditure for fiscal years 1984 through 1987. This budget report was prepared, and is submitted to you, pursuant to the requirements of Minnesota Statutes, 1983 Supplement, Section 270.067 (Laws of 1983, Chapter 301).

Sincerely,

Arthur C. Roemer

Arthur C. Roemer
Commissioner of Revenue

PREFACE/ACKNOWLEDGEMENTS

In the course of producing this report many hundreds of provisions of law were examined to determine whether they represented tax expenditures. Numerous staff persons, both within the Department of Revenue and other state agencies, were necessarily consulted and a large number of decisions were made.

The Department of Public Safety provided invaluable assistance in estimating the impacts for identified tax expenditures within the motor vehicle registration tax. Within the Department of Revenue, Wes Skjegstad of the Income Tax Division was especially helpful, as well as Howard Anderson of Special Taxes, and Donald Walsh of the Minerals Tax Division. Each of these persons was called upon to help resolve close questions of law or fact, and their willingness to disrupt their normal activities to provide that assistance helped to improve the completeness and accuracy of this report. The actual production of the final version of this report was in the hands of a team of specialists and student workers in the Research Office of the Department of Revenue. That team consisted of Carolyn Carlson, Gary Corwin, Douglas DeGrote, John Lorbiecki, Thomas Pahl, and Robert Riley, with significant contributions from various Research Office staff members including Rod Hoheisel, Carole Wald, Nancy Edwardson, and Diane Carter.

The hundreds of decisions that had to be made during the course of producing this report generally reflected the consensus opinion of those involved, although many times other decisions could as easily have been defended. The reader should approach this study with an appreciation for the close questions that had to be resolved, and for the fact that another group of equally reasonable persons might well have resolved a particular question or issue differently. That particular decisions could have been different should not impair the overall usefulness of this report.

Questions or comments relating to this report may be directed to:

Minnesota Department of Revenue
Research Office — 113
P.O. Box 64446
St. Paul, Minnesota 55164
Telephone: (612) 296-3425

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WHY A TAX EXPENDITURE BUDGET?

The 1983 Minnesota Legislature enacted Minnesota Statutes, Section 270.067, which requires the Commissioner of Revenue to prepare a tax expenditure budget to be submitted to the Legislature in 1985 as a supplement to the Governor's Biennial Budget. The study must review, at a minimum, a three-year period including the two years covered in the Governor's Budget. The purpose, as stated in the statute, is ". . . to facilitate a regular review of the . . . tax expenditure budget by the legislature . . ."

This report is the first tax expenditure budget prepared for the State of Minnesota and is, therefore, the first opportunity to review comprehensively all tax expenditures in the same manner and at the same time as the expenditures contained in the biennial budget.

Government expenditures that are contained in a budget are subject to review to determine if programs should be continued as they are, changed, or discontinued. The tax expenditure budget provides information to enable this type of review to be made for tax expenditure items. By providing an inventory of tax expenditure items and certain information for each item, it can be a useful tool in the decision-making process.

Tax expenditures get their name because of their similarities to direct government expenditures. Direct government expenditures are made for a wide variety of public policy purposes. Expenditures may be aimed at encouraging desirable social outcomes or at discouraging undesirable ones. Similarly, tax expenditures can be used to achieve those same objectives.

Government can use direct expenditures to support nonprofit organizations through grants, low-cost loans, or other direct means. Alternatively, it can indirectly support nonprofit organizations through special income, sales, or property tax provisions. For example, by allowing deductions for charitable contributions in computing the income tax, government encourages such contributions by, in effect, lowering their cost and creates a tax expenditure.

Although considerable disagreement exists among both theorists and practitioners over the exact definition of a tax expenditure, it is generally agreed that a tax expenditure is created when government spends money through the tax structure by enacting preferential provisions. The specific criteria used to determine which items were included as tax expenditures for this report are explained in detail on pages 4&5.

WHAT DO THE ESTIMATES MEASURE AND WHAT ARE THEIR LIMITATIONS?

Two main points must be kept in mind in order to understand the estimates of fiscal impact for each tax expenditure and the limitations of those estimates.

- **Estimates measure the amount of tax relief provided, not the revenue to be gained by repeal.**

The estimates of fiscal impact for each tax expenditure measure the amount of tax relief provided through the tax expenditure. The estimates in this report do not necessarily measure the amount of tax revenue to be gained by the repeal of any tax expenditure item. This distinction is important. If potential revenue gain were to be estimated, other variables would have to be considered, including the timing of the repeal or other change, changes in taxpayer behavior, and interactions within a tax or between taxes.

For example, the fiscal impact estimate for the charitable contribution deduction reflects established patterns of contributions to charitable organizations. It does not reflect the likelihood that taxpayers would contribute less to charitable organizations and more to other organizations if this income tax deduction were not available to them.

•Combining the estimates for two or more tax expenditure items can be misleading.

The fiscal impact for each tax expenditure item is estimated in isolation. That is, generally other provisions of the affected tax and provisions of other taxes are not simultaneously considered. Therefore, interactions between tax provisions are not included in the estimates, and overcounting will occur in some situations, such as when one tax is a deduction or credit in determining another tax. For example, the sales tax is a deduction in computing the individual income tax. The tax expenditure estimate for the tax relief provided by the sales tax exemption for food does not take into account that income taxes are higher because food is exempt from the sales tax.

Because each estimate is made in isolation, undercounting can occur when tax expenditure provisions overlap and when the combined effect of two or more tax expenditures would change the marginal tax rates appropriate to the fiscal impact calculation.

An example of the type of undercounting which occurs when tax expenditures overlap can be found in the sales tax. One tax expenditure in the sales tax covers all government purchases and another provision exempts food sales. Which exemption applies when a government agency purchases food? In this report, it is assumed that the balance of the tax structure remains constant when the fiscal impact of an individual item is estimated. Therefore, the sales tax that could be collected on food purchases by government agencies is not in either estimate.

The second type of undercounting occurs in those taxes which have a graduated rate structure, such as the individual income tax. Because of the graduated rate structure of the individual income tax, the amount of tax relief provided by a particular deduction is based on the marginal, or highest, rate which applies to individuals claiming that deduction. If that deduction were not available, the marginal rate would be pushed higher. Therefore, the estimates for the combined impact of two or more deductions would need to take into account a higher level of marginal rates than is done when each item is treated separately.

WHAT IS INCLUDED IN THIS STUDY?

Minnesota Statutes, Section 270.067, Subd. 6, requires that the tax expenditure budget must cover "any tax of statewide application or any tax authorized by state law to be levied by local governments generally." For purposes of this study, licensing fees are not considered to be taxes and are not included in this report. Statewide taxes for which no tax expenditures are identified are listed in the appendix.

In this report the tax expenditures are listed sequentially by the type of tax in the following five categories:

- Income and estate taxes
- Sales and excise taxes
- Gross earnings and special taxes
- Severance and tonnage taxes
- Property taxes

The tax expenditures for a particular tax appear in the order that is followed in the computation of the tax. For the individual income tax, for example, the tax expenditures relating to deductions from income appear before the ones relating to credits against the tax.

Minnesota Statutes, Section 270.067, Subd. 4, contains this requirement: "The report shall detail for each tax expenditure item the amount of tax revenue foregone, a citation of the statutory or other legal authority for the expenditure, and the year in which it was enacted or the tax year in which it became effective." These details are provided in this report.

The statute goes on to mention additional information that may be provided: the intended purpose of the tax expenditure; analysis of whether it is achieving that purpose; and the effect of the tax expenditure on the distribution of the tax burden and on tax administration. Because of resource limitations, this tax expenditure budget does not include this optional information.

The following information is included for each tax expenditure item.

Title: Each entry has a title which is intended to be as descriptive as possible, often taken directly from statutory language.

Citation: The source of authorization is given. In most cases the reference is to Minnesota statutes, and, where appropriate, federal law. Some items are authorized by rules or rulings. In these cases the applicable rule or ruling is cited.

Definition: Definitions are intended to be complete but brief. Information about the tax base, the mechanics of the provision, who benefits from the provision, and relevant historical data are often included. A historical statement briefly explains one or more of the following: when the provision was first enacted, when it became effective, and when it was last changed.

Fiscal Impact: The fiscal impact is the amount being spent due to the provision for fiscal years 1984 through 1987. Once again, this should not be equated with potential revenue to be gained from the repeal of an item. As discussed previously, the two may be very different.

When the word "minimal" appears instead of a numerical estimate, the fiscal impact is estimated as less than $100,000 for that fiscal year.

WHAT IS A TAX EXPENDITURE?

The criteria used to determine which items are included as tax expenditures in this report are intended to be objective and consistent. The inclusion of an item in this report is not intended to reflect a judgment as to either its desirability, purpose, or effectiveness.

A tax provision must meet all the following criteria to be included as a tax expenditure. It must:

- Affect a tax that is applied statewide.
- Be included in the defined tax base.
- Confer preferential treatment on a subset of taxpayers.
- Result in reduced tax revenue.
- Not be subject to an alternative tax.
- Be able to be changed by legislative action alone.

Each criterion is explained in the discussion that follows.

The determination of whether an item is a tax expenditure for this report begins with the definitions given in the statutes requiring this report, Minnesota Statutes, Section 270.067, Subd. 6:

> (1) "Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue.
>
> (2) "Tax" means any tax of statewide application or any tax authorized by state law to be levied by local governments generally. It does not include a special local tax levied pursuant to a special law or to a special local tax levied pursuant to general authority that is no longer applicable to local governments generally.

The economic activity on which the tax burden is placed is referred to as the tax base for that tax. Once the tax base is determined, the tax expenditures may then be identified. This approach implies that when something is outside the tax base, it cannot be a tax expenditure. For example, if the tax is levied on net income, deductions given to derive net income, such as business expenses, are not judged to be tax expenditures since such deductions are generally considered to be necessary in computing the defined base. However, the deduction of portions of pension income is viewed as a tax expenditure since that exclusion is not required in the computation of net income.

An item is not a tax expenditure if it provides general tax relief to all the taxpayers subject to that tax. Such a provision is considered to be part of the tax structure. Graduated and two-step rate structures, such as those for the individual and corporate income taxes respectively, are not considered tax expenditures because each taxpayer with the same amount of tax base pays at the same rate. However, preferential rates, such as the lower sales tax rate for farm machinery, are tax expenditures because it is the type of tax base which qualifies for the lower rate, not the amount of the base.

To be included as a tax expenditure in this report, a provision must result in reduced tax revenue for the time period covered (fiscal years 1984 through 1987).

If an activity is exempt from one tax but subject to an alternative tax, a tax expenditure is not created in the first tax.

Finally, this report includes only those items which the state could repeal by legislative action alone. Some items that would otherwise qualify as tax expenditures are not considered tax expenditures because to be eliminated they would require either a state constitutional amendment, a federal law change, or a federal constitutional amendment.

A provision must meet all the above criteria to be included as a tax expenditure in this report. Many items meet some but not all criteria and therefore are not in the main body of this report. An appendix is provided showing examples of items that would have been tax expenditures except they failed to meet one criterion.

WHAT IS THE HISTORY OF TAX EXPENDITURES AND TAX EXPENDITURE BUDGETS?

Tax expenditures have been a part of Minnesota's tax system for as long as there have been taxes. As early as 1851, six years prior to statehood, the Territory of Minnesota compiled its first book of statutes which included several property tax expenditures. All real and personal property within the territory was subject to a general tax, except for these "tax expenditures" exempting:

1. All public or corporate property of Minnesota's counties, cities, villages, towns, and school districts.
2. The household furniture of every head of a family up to a maximum of $100.
3. The personal property of all literary, benevolent, charitable and scientific institutions incorporated within Minnesota.
4. All public libraries.
5. The personal property of all persons who, by reason of infirmity, age and poverty, may, in the opinion of the assessor, be unable to contribute to the public charges.

The first Minnesota tax expenditure in another tax was enacted in 1863. Rather than increasing property taxes, the Legislature enacted a poll tax on all legal voters over the age of twenty-one. As part of this provision soldiers were specifically excluded from the tax, even though they were part of the taxable group of legal voters. By exempting soldiers from what was otherwise a general tax, a tax expenditure was created.

Probably the most historically significant event contributing to the growth of tax expenditures in Minnesota occurred in 1905. In that year the Minnesota Legislature passed the so-called "wide-open" amendment, ratified at the polls in 1906. This key amendment replaced language in Article IX of the Constitution which until that time had restricted the state's powers of taxation by requiring that all taxes be "equal and uniform throughout the state". This prior language generally required that each tax had to be levied uniformly against everyone.

The wide-open amendment allows the Legislature to treat taxpayers differently as long as the taxes are uniform as to each class of subjects. The amendment helped pave the way for an income tax in 1933 and generally contributed towards the growth of Minnesota's diverse tax structure. This diversification process in turn allowed and encouraged the increased usage of tax expenditure devices over the years in Minnesota.

Tax expenditures may be as old as taxation, but the notion of listing such items for budget discussions is a much more recent development, only first introduced in the 1960's. The federal government began reviewing corporate and individual income tax expenditures as early as 1967. However, a tax expenditure budget was not officially incorporated into the decision-making process until 1974. In that year Congress passed a law requiring the Treasury Department to produce an annual report. Since that time several states and foreign governments have also begun producing tax expenditure reports. By providing information on the amount of indirect government tax support of various activities and groups, tax expenditure budgets have proven that they can contribute to a comprehensive understanding of total governmental expenditures.

TAX EXPENDITURE SUMMARY LIST

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
INDIVIDUAL INCOME TAX					
Federal Exclusions					
1.01	Employee Meals and Lodging	$ 11,000,000*	$ 12,000,000	$ 12,000,000	$ 13,000,000
1.02	Merchandise Distributed to Employees on Holidays	280,000*	270,000	290,000	300,000
1.03	Employee Discounts	5,100,000*	5,300,000	5,900,000	6,500,000
1.04	Employer Educational Assistance (Repealed)	340,000*	0	0	0
1.05	Employer-Provided Child Care	160,000*	470,000	720,000	1,000,000
1.06	Value of Employer-Provided Commuter Vehicles (Repealed)	Minimal*	Minimal	Minimal	0
1.07	Employer Contributions to Prepaid Legal Services Plans (Repealed)	320,000*	290,000	0	0
1.08	Employer Contributions to Pensions and Pension Earnings	150,000,000*	140,000,000	160,000,000	170,000,000
1.09	Employer Contributions for Medical Insurance Premiums and Medical Care	140,000,000*	140,000,000	160,000,000	190,000,000
1.10	Employer-Paid Accident and Disability Premiums	1,000,000*	1,000,000	1,000,000	1,000,000
1.11	Employer-Paid Group Term Life Insurance Premiums	19,000,000*	19,000,000	21,000,000	23,000,000
1.12	Income Earned Abroad by U.S. Citizens and Employer-Paid Foreign Housing Costs	2,300,000*	2,200,000	2,300,000	2,500,000
1.13	Benefits and Allowances to Armed Forces Personnel	6,000,000*	5,600,000	6,000,000	6,300,000
1.14	Veterans' Benefits Administered by the Veterans Administration	32,600,000*	31,500,000	33,500,000	36,000,000
1.15	Military Disability Pensions	620,000*	580,000	590,000	610,000
1.16	Disability Pay (Repealed)	1,800,000*	0	0	0

* Estimate includes 10% surcharge.

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
1.17	Special Benefits for Disabled Coal Miners	$ Minimal*	$ Minimal	$ Minimal	$ Minimal
1.18	Workers' Compensation Benefits	17,000,000*	18,000,000	20,000,000	23,000,000
1.19	Cash Public Assistance	2,000,000*	1,900,000	2,200,000	2,600,000
1.20	Gifts	15,590,000*	14,890,000	16,090,000	16,990,000
1.21	Life Insurance	58,000,000*	58,000,000	64,000,000	70,000,000
1.22	Dividends	4,900,000*	4,400,000	4,400,000	4,400,000
1.23	Reinvestment of Dividends in Public Utility Stock (Repealed)	3,300,000*	3,400,000	5,000,000	0
1.24	Net Interest Exclusion	0	0	15,000,000	25,000,000
1.25	Interest on General Purpose State and Municipal Debt	43,000,000*	43,000,000	45,000,000	48,000,000
1.26	Interest on Nonguaranteed State and Municipal Debt	71,000,000*	77,000,000	92,000,000	104,000,000
1.27	Certain Agricultural Cost-Sharing Payments	1,100,000*	930,000	700,000	580,000
1.28	Sixty Percent Capital Gains Exclusion (other than Homes, Agricultural, Coal, Timber and Iron Ore)	210,000,000*	200,000,000	220,000,000	230,000,000
1.29	Capital Gains Treatment of Certain Agricultural Income	13,000,000*	12,000,000	13,000,000	14,000,000
1.30	Capital Gains Treatment of Certain Timber Income	1,100,000*	1,100,000	1,400,000	1,600,000
1.31	Capital Gains Treatment of Iron Ore Royalties	3,200,000*	2,900,000	2,900,000	2,900,000
1.32	Capital Gains Treatment of Coal Royalties	640,000*	640,000	700,000	760,000
1.33	Special Treatment of Capital Gains on Home Sales	57,000,000*	60,000,000	64,000,000	69,000,000
1.34	Capital Gains at Death	30,000,000*	31,000,000	34,000,000	38,000,000
1.35	Income from the Discharge of Debt	Minimal*	Minimal	Minimal	Minimal
1.36	Automobile Owners' Car Pool Receipts	Minimal*	Minimal	Minimal	Minimal

* Estimate includes 10% surcharge.

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
Federal Deductions					
1.37	Depreciation	$ 8,300,000*	$ 11,000,000	$ 21,000,000	$ 29,000,000
1.38	Amortization of Business Start-up Costs	1,000,000*	1,400,000	2,000,000	2,700,000
1.39	Amortization of Motor Carrier Operating Rights	Minimal*	Minimal	Minimal	0
1.40	Five-Year Amortization for Housing Rehabilitation	370,000*	340,000	340,000	340,000
1.41	Five-Year Amortization for Rehabilitation of Historic Structures (Repealed)	Minimal*	Minimal	Minimal	0
1.42	Seven-Year Amortization for Reforestation Expenditures	Minimal*	Minimal	Minimal	Minimal
1.43	Excess of Percentage Over Cost Depletion for Oil, Gas, and Non-Fuel Minerals	2,200,000*	2,100,000	2,000,000	2,000,000
1.44	Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	13,000,000*	12,000,000	12,000,000	13,000,000
1.45	Expensing of Research and Development Costs	720,000*	730,000	750,000	760,000
1.46	Expensing of Exploration and Development Costs	3,100,000*	2,400,000	2,500,000	2,500,000
1.47	Individual Retirement Accounts	49,000,000*	52,000,000	64,000,000	79,000,000
1.48	Keogh Plans	750,000*	420,000	380,000	370,000
1.49	Foreign Housing Costs Paid by Taxpayer	240,000*	180,000	190,000	190,000
1.50	Employment-Related Moving Expenses	8,000,000*	11,000,000	12,000,000	13,000,000
Minnesota Adjustments					
1.51	Pension, Retirement or Severance Income (Other than Social Security or Railroad Retirement Benefits)	87,000,000*	94,000,000	114,000,000	132,000,000
1.52	Unemployment Compensation	67,000,000*	39,000,000	44,000,000	50,000,000
1.53	Social Security Benefits	300,000,000*	289,000,000	313,000,000	338,000,000

* Estimate includes 10% surcharge.

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
1.54	Federal Income Taxes	$590,000,000*	$620,000,000	$680,000,000	$740,000,000
1.55	Military Pay	14,000,000*	13,000,000	14,000,000	16,000,000
1.56	Expense Money Paid to Legislators	140,000*	Minimal	150,000	Minimal
1.57	Interest on Family Farm Security Loans	630,000*	630,000	730,000	720,000
1.58	Interest on Contract-for-Deed Sales of Agricultural Land	220,000*	220,000	210,000	210,000
Minnesota Deductions					
1.59	Itemized Deduction Allocation	15,000,000*	16,000,000	17,000,000	18,000,000
1.60	Standard Deduction	99,000,000*	105,000,000	114,000,000	125,000,000
1.61	Medical and Dental Expenses	59,000,000*	60,000,000	63,000,000	67,000,000
1.62	Real Estate Taxes (Reduced by by Property Tax Refund)	79,000,000*	78,000,000	84,000,000	91,000,000
1.63	General Sales Tax	37,000,000*	38,000,000	42,000,000	46,000,000
1.64	Motor Vehicle Excise Tax	12,000,000*	14,000,000	16,000,000	17,000,000
1.65	Motor Vehicle Registration Tax	7,600,000*	7,500,000	8,400,000	9,400,000
1.66	Interest on Home Mortgages	250,000,000*	270,000,000	320,000,000	390,000,000
1.67	Nonmortgage Interest	100,000,000*	100,000,000	110,000,000	110,000,000
1.68	Charitable Contributions	100,000,000*	100,000,000	120,000,000	130,000,000
1.69	Nonbusiness Casualty and Theft Losses	1,600,000*	1,500,000	1,600,000	1,700,000
1.70	Tax Return Preparation Fees	5,800,000*	5,900,000	6,400,000	6,800,000
1.71	Adoption Expenses	190,000*	180,000	190,000	200,000
1.72	Deduction for Tuition, Transportation, and Nonreligious Textbooks for Dependents	6,100,000*	5,800,000	7,300,000	7,700,000
Minnesota Credits					
1.73	Personal Credits for Age 65 and Over, Blind, Deaf, and Quadriplegic	20,726,000	21,777,000	23,843,000	25,929,000
1.74	Personal Credits for Dependents	79,000,000	83,000,000	86,000,000	90,000,000

* Estimate includes 10% surcharge.

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
1.75	Homemaker Credit	$ 2,300,000	$ 2,300,000	$ 2,200,000	$ 2,000,000
1.76	Credit for Income Tax Paid to Other States and Reciprocity	4,600,000	5,300,000	6,000,000	7,000,000
1.77	Political Contribution Credit	4,300,000	6,100,000	5,900,000	7,400,000
1.78	Residential Energy Credit (Repealed)	2,800,000	3,800,000	5,800,000	500,000
1.79	Low Income Credit	8,500,000	8,100,000	7,800,000	7,400,000
1.80	Pollution Control Credits	300,000	Minimal	2,000,000	2,000,000
1.81	Research and Development Credit	310,000	360,000	400,000	400,000
1.82	Credit for Equity Investment in a Small Business (Repealed)	0	110,000	110,000	Minimal
1.83	Resource Recovery Equipment Credit	0	Minimal	Minimal	Minimal
1.84	Conservation Tillage Equipment Credit	0	280,000	350,000	440,000
1.85	Child and Dependent Care Credit	8,000,000	14,000,000	15,000,000	16,000,000
1.86	Construction Financing (Enterprise Zones)	Minimal	Minimal	Minimal	Minimal
1.87	Tax Credit for Employees (Enterprise Zones)	Minimal	Minimal	Minimal	Minimal

CORPORATE INCOME TAX

Exclusions

		1984	1985	1986	1987
2.01	Tax-Exempt Organizations	290,000	320,000	350,000	400,000
2.02	Credit Unions	900,000	1,000,000	1,200,000	1,300,000
2.03	Deferral of Income from Controlled Foreign Corporations	970,000	1,100,000	1,100,000	0
2.04	Unrelated Income (Insurance Companies)	Minimal	Minimal	Minimal	Minimal
2.05	Underwriting Income (Life Insurance Companies)	Minimal	Minimal	Minimal	Minimal
2.06	Fee Income (Life Insurance Companies)	Minimal	Minimal	Minimal	Minimal

* Estimate includes 10% surcharge.

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
2.07	Royalties (Life Insurance Companies)	$ Minimal	$ Minimal	$ Minimal	$ Minimal
Deductions					
2.08	Foreign Source Dividends	0	0	0	4,000,000
2.09	Foreign Source Royalties	0	0	5,700,000	6,700,000
2.10	Sixty Percent Capital Gains Deduction	19,000,000	23,000,000	24,000,000	24,000,000
2.11	Safe-Harbor Leasing (Depreciation Component) (Repealed)	5,300,000	4,900,000	4,000,000	5,200,000
2.12	Depreciation	21,000,000	20,000,000	19,000,000	19,000,000
2.13	Excess of Percentage Over Cost Depletion for Copper-Nickel Mining	Minimal	Minimal	Minimal	Minimal
2.14	Amortization of Organizational and Start-Up Costs	Minimal	110,000	130,000	150,000
2.15	Expensing of Research and Development Costs	8,300,000	8,500,000	8,700,000	8,900,000
2.16	Expensing of Mineral Exploration and Development Costs	120,000	130,000	150,000	170,000
2.17	Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	550,000	580,000	610,000	620,000
2.18	Charitable Contributions	7,800,000	8,400,000	9,000,000	9,600,000
2.19	Dividend Received Deduction	28,000,000	34,000,000	35,000,000	20,000,000
2.20	Weighted Apportionment	72,000,000	88,000,000	90,000,000	90,000,000
2.21	Throwback Sales	24,000,000	24,000,000	24,000,000	24,000,000
2.22	Net Operating Loss (Carryback/Carryover)	27,000,000	32,000,000	37,000,000	38,000,000
2.23	Deductions Allowing Corporations to be Taxed as a Partnership	33,280,000	38,300,000	41,320,000	46,350,000
2.24	Excess Reserves for Bad Debt (Banks)	4,500,000	5,600,000	6,100,000	7,100,000
2.25	Patronage Dividends (Cooperatives)	6,400,000	6,600,000	6,800,000	7,000,000

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
2.26	Exempt Interest (Insurance Companies)	$ 730,000	$ 810,000	$ 890,000	$ 970,000
2.27	Sums Paid Out Other Than Dividends (Mutual Insurance Companies)	Minimal	Minimal	Minimal	Minimal
2.28	Mean Reserves (Life Insurance Companies)	8,400,000	9,000,000	9,500,000	10,000,000
2.29	Reserves for Deferred Dividends (Life Insurance Companies)	Minimal	Minimal	Minimal	Minimal
Credits					
2.30	Pollution Control Credits	500,000	150,000	1,100,000	1,100,000
2.31	Resource Recovery Equipment Credit	0	480,000	480,000	480,000
2.32	Energy Credit (Repealed)	Minimal	0	0	0
2.33	Conservation Tillage Equipment Credit	Minimal	Minimal	Minimal	Minimal
2.34	Research and Development Credit	7,300,000	7,400,000	7,500,000	7,600,000
2.35	Construction Financing (Enterprise Zones)	Minimal	340,000	190,000	190,000
2.36	Tax Credits for Employees (Enterprise Zones)	1,300,000	2,400,000	2,000,000	2,000,000
2.37	Credit for Technology Transfers to Small Businesses (Repealed)	0	900,000	900,000	0
2.38	Credit for Contributions to Small Business Assistance Offices (Repealed)	0	230,000	230,000	0
2.39	Credit for Equity Investment in a Small Business (Repealed)	0	1,300,000	1,300,000	Minimal
2.40	Credit for Gross Premiums Tax (Insurance Companies)	20,000,000	25,000,000	25,000,000	25,000,000
2.41	Minnesota Comprehensive Health Association Assessment Credit (Insurance Companies) (Repealed)	130,000	0	0	0

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
ESTATE TAX					
Preferential Valuations					
3.01	Alternate Valuation of Property	$ 110,000	$ 100,000	$ Minimal	$ Minimal
3.02	Special Use Valuation	1,100,000	940,000	880,000	740,000
Exclusions					
3.03	Charitable Gifts	3,700,000	3,600,000	3,500,000	3,500,000
3.04	Pensions and Annuities	370,000	290,000	250,000	200,000
3.05	Social Security Benefits	Minimal	Minimal	Minimal	Minimal
3.06	Veterans' Burial Benefits	Minimal	Minimal	Minimal	Minimal
3.07	Proceeds from Military Veterans' Life Insurance	Minimal	Minimal	Minimal	Minimal
Deductions					
3.08	Marital Deduction	20,000,000	18,000,000	17,000,000	16,000,000
Credits					
3.09	Previously Paid Estate or Inheritance Tax	300,000	300,000	300,000	300,000
GENERAL SALES AND USE TAX					
Exemptions — Particular Goods and Services					
4.01	Food	240,000,000	260,000,000	280,000,000	300,000,000
4.02	Clothing and Wearing Apparel	120,000,000	130,000,000	140,000,000	150,000,000
4.03	Publications	8,700,000	9,400,000	10,000,000	11,000,000
4.04	Drugs and Medicines	31,000,000	33,000,000	36,000,000	39,000,000
4.05	Prescription Glasses	5,100,000	5,600,000	6,300,000	7,100,000
4.06	Therapeutic and Prosthetic Devices	2,700,000	3,000,000	3,300,000	3,700,000
4.07	Feminine Hygiene Items	1,400,000	1,500,000	1,600,000	1,700,000
4.08	Textbooks	1,100,000	1,300,000	1,400,000	1,600,000

	Tax Expenditure Item	Fiscal Year Impact 1984	1985	1986	1987
4.09	Motor Vehicles	$ 0	$ 0	$ 0	$ 0
4.10	Race Horses	Minimal	Minimal	110,000	240,000
4.11	Caskets and Burial Vaults	2,000,000	2,000,000	2,100,000	2,200,000
4.12	Accessory Tools	13,000,000	14,000,000	15,000,000	16,000,000
4.13	Personal Property Brought into Minnesota	3,800,000	3,900,000	4,000,000	4,200,000
4.14	Packing Materials	Minimal	Minimal	Minimal	Minimal
4.15	Leases of Drive-It-Yourself Automobiles	Minimal	Minimal	Minimal	Minimal
4.16	Goods Shipped or Transported Out of State	230,000	250,000	260,000	270,000
4.17	Resource Recovery Equipment	0	300,000	300,000	300,000
4.18	Club Dues	5,000,000	5,500,000	6,000,000	6,600,000
4.19	Admission Fees to Recreational Areas	480,000	520,000	580,000	650,000
4.20	Admission to Artistic Performances	2,000,000	2,100,000	2,200,000	2,300,000
4.21	Meals Given to Employees	1,800,000	1,900,000	2,000,000	2,100,000
4.22	Services	360,000,000	390,000,000	434,000,000	482,000,000
4.23	Residential Sewer Services	5,500,000	5,800,000	6,100,000	6,400,000
4.24	Residential Water Services	5,800,000	6,300,000	7,000,000	7,700,000
4.25	Residential Heating Fuels	61,000,000	63,000,000	65,000,000	68,000,000
4.26	Interstate Telephone Service	18,000,000	21,000,000	24,000,000	27,000,000
Exemptions — Sales to Particular Groups					
4.27	Sales to Local Governments	37,000,000	41,000,000	45,000,000	49,000,000
4.28	Sales to Nonprofit Organizations	17,000,000	18,000,000	19,000,000	21,000,000
4.29	Sales to Veterans' Organizations	Minimal	Minimal	Minimal	Minimal
4.30	Sales of Building Materials to Disabled Veterans	Minimal	Minimal	Minimal	Minimal

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
4.31	Construction Materials or Equipment (Enterprise Zones)	$ 110,000	$ 1,000,000	$ 900,000	$ 900,000
4.32	New Satellite Broadcasting Facility	0	300,000	600,000	300,000
Exemptions — Sales by Particular Groups					
4.33	Isolated or Occasional Sales	10,000,000	10,000,000	11,000,000	12,000,000
4.34	Institutional Meals	11,000,000	12,000,000	13,000,000	14,000,000
4.35	Candy Sales by Organizations Which Provide Services to Minors	0	Minimal	Minimal	Minimal
Special Rates/Reduced Sales Price					
4.36	Four Percent Rate for Farm Machinery	12,000,000	12,000,000	13,000,000	13,000,000
4.37	Four Percent Rate for Logging Equipment	0	260,000	280,000	300,000
4.38	Four Percent Rate for Capital Equipment Sold to New or Expanding Industries	0	5,400,000	10,000,000	12,000,000
4.39	Four Percent Rate for Special Tooling	0	170,000	180,000	190,000
4.40	Taxes Imposed by the U.S. Government	6,100,000	6,700,000	7,500,000	8,500,000
4.41	Taxes Paid to Other States	400,000	400,000	400,000	400,000
MOTOR VEHICLE EXCISE TAX					
Exemptions					
5.01	Vehicles Acquired by Inheritance	2,300,000	2,400,000	2,500,000	2,500,000
5.02	Out-of-State Acquisitions	670,000	700,000	730,000	770,000
5.03	Transfers Between Joint Owners	460,000	480,000	500,000	520,000
5.04	Transfers Between Spouses, Parents and Children, and Guardians and Wards	9,300,000	9,700,000	10,100,000	10,600,000
5.05	Transfers in Divorce Proceedings	200,000	210,000	230,000	250,000

		Fiscal Year Impact			
	Tax Expenditure Item	1984	1985	1986	1987
5.06	Corporate and Partnership Transfers	$ Minimal	$ Minimal	$ Minimal	$ Minimal
5.07	Sales to Nonprofit Organizations	620,000	650,000	680,000	710,000
5.08	Sales to Local Governments	1,000,000	1,000,000	1,200,000	1,300,000
5.09	Sales to Disabled Veterans	Minimal	Minimal	Minimal	Minimal
5.10	Motor Carrier Leasing	Minimal	Minimal	Minimal	Minimal
5.11	Federal Excise Taxes	240,000	260,000	280,000	300,000
Credits					
5.12	Credit for Taxes Paid to Other States	Minimal	Minimal	Minimal	Minimal
MOTOR FUELS EXCISE TAXES					
Exemptions					
6.01	City-Owned Transit Systems	1,789,000	1,790,000	1,791,000	1,792,000
6.02	Reciprocal Agreements for Out-of-State Purchases	460,000	460,000	460,000	460,000
Refunds					
6.03	Refund for Out-of-State Driving (Special Fuels)	2,600,000	2,900,000	3,100,000	3,400,000
Special Rates					
6.04	Border Rates	110,000	220,000	220,000	220,000
6.05	Gasohol Rates for General Public (Gasoline)	360,000	710,000	2,100,000	2,800,000
6.06	Gasohol Rates for Governmental Units and Schools (Gasoline)	Minimal	Minimal	Minimal	Minimal
INTOXICATING LIQUORS TAXES					
Exemptions					
7.01	Consumer Purchases Made Out of State	1,220,000	1,220,000	1,220,000	1,220,000
7.02	Alcoholic Beverages Sold to Food Processors	Minimal	Minimal	Minimal	Minimal

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
7.03	Consumption on Brewery Grounds (Fermented Malt Beverages)	$ Minimal	$ Minimal	$ Minimal	$ Minimal
7.04	Breakage or Destruction at a Wholesaler's Warehouse (Distilled Spirits and Wine)	Minimal	Minimal	Minimal	Minimal
7.05	Wine Used In Production Process	Minimal	Minimal	Minimal	Minimal
7.06	Home Fermentation (Wine and Beer)	160,000	160,000	160,000	160,000
7.07	Wine for Sacramental Purposes	Minimal	Minimal	Minimal	Minimal
Credits					
7.08	Minnesota Brewers' Credit (Fermented Malt Beverages)	390,000	390,000	390,000	390,000
Special Rates					
7.09	Minnesota Vintners' Rates (Wine)	Minimal	Minimal	Minimal	Minimal
TOBACCO TAXES					
Exemptions					
8.01	Sales to Minnesota Correctional Institutions	124,000	126,000	117,000	119,000
8.02	Limited Quantities Exempt	370,000	370,000	370,000	370,000
MORTGAGE REGISTRY TAX					
Exemptions					
9.01	Certain Persons and Corporations Exempt	Minimal	Minimal	Minimal	Minimal
DEED STAMP TAX					
Exemptions					
10.01	Transfers between Co-Owners	Minimal	Minimal	Minimal	Minimal
10.02	Transfers Involving Government Agencies	260,000	290,000	320,000	350,000

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
10.03	Deeds for Cemetery Lots	$ Minimal	$ Minimal	$ Minimal	$ Minimal
TELEPHONE COMPANIES GROSS EARNINGS TAXES					
Special Rates					
11.01	Four Percent Rate	13,000,000	14,000,000	15,000,000	16,000,000
INSURANCE PREMIUMS TAXES					
Exemptions					
12.01	Cooperative Life and Casualty Companies	Minimal	Minimal	Minimal	Minimal
12.02	Auto and Ocean Marine Fire Premiums of Domestic Mutual Insurance Companies	490,000	520,000	570,000	650,000
12.03	Fraternal Beneficiary Associations	1,700,000	1,800,000	2,000,000	2,200,000
12.04	Medical and Hospital Service Associations	6,300,000	6,700,000	7,100,000	7,500,000
12.05	Farmers' Mutual and Township Mutual Fire Insurance Companies (Fire Marshal Tax)	130,000	140,000	150,000	170,000
Credits					
12.06	Payments to the Minnesota Comprehensive Health Association	3,400,000	3,600,000	3,800,000	3,900,000
Preferential Computations					
12.07	Three Year Averaging (Ocean Marine Profits Tax)	Minimal	Minimal	Minimal	Minimal
TACONITE PRODUCTION TAX					
Credits					
13.01	Water Filtration Plant Credit	0	250,000	250,000	250,000
MINING OCCUPATION TAXES					
Credits					
14.01	Labor Credit	14,000,000	18,000,000	18,000,000	18,000,000

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
14.02	Pollution Control Credit	$ Minimal	$ Minimal	$ Minimal	$ Minimal
14.03	Research, Experimentation, and Exploration Credit	200,000	280,000	280,000	280,000
14.04	Loss Mine Credit (Other Than Taconite)	Minimal	Minimal	Minimal	Minimal
14.05	Discount Credit (Other Than Taconite)	Minimal	Minimal	Minimal	Minimal
ROYALTY TAXES					
Credits					
15.01	Labor Credit	5,100,000	3,400,000	3,900,000	3,900,000
15.02	Loss Mine	Minimal	Minimal	Minimal	Minimal
	Constitutional Limit on the Taxation of Taconite Mining Companies	N/A	N/A	N/A	N/A
GENERAL PROPERTY TAX					
Exemptions					
16.01	Exempt Property	415,000,000	444,000,000	474,000,000	505,000,000
Preferential Valuations					
16.02	Classification System	N/A	N/A	N/A	N/A
16.03	Green Acres Treatment of Agricultural Land	3,100,000	4,100,000	5,600,000	7,600,000
Alternative Taxes					
16.04	Auxiliary Forest Tax and Tree Growth Tax	760,000	860,000	950,000	1,050,000
Credits					
16.05	Power Line Credit	170,000	180,000	200,000	220,000

Tax Expenditure Item		Fiscal Year Impact 1984	1985	1986	1987
MOTOR VEHICLE REGISTRATION TAX					
Exemptions					
17.01	Government Vehicles	$ 1,900,000	$ 2,000,000	$ 2,000,000	$ 2,100,000
17.02	Educational Institutions — Buses	Minimal	Minimal	Minimal	Minimal
17.03	Nonresident Military Personnel	Minimal	Minimal	Minimal	Minimal
17.04	Medal of Honor Recipients	Minimal	Minimal	Minimal	Minimal
17.05	Disabled Veterans	Minimal	Minimal	Minimal	Minimal
Credits					
17.06	Physically Handicapped Persons	Minimal	Minimal	Minimal	Minimal

CHAPTER 1: INDIVIDUAL INCOME TAX

INTRODUCTION

History and Collections

Minnesota first considered an income tax in 1891, when the state Senate passed a bill providing for a two percent tax on net incomes above $2,000. The House of Representatives, however, failed to pass the measure and it did not become law. It was not until some forty years later that the Legislature, in 1933, enacted an income tax for both individuals and corporations. The federal income tax had been adopted twenty years earlier in 1913.

The original Minnesota income tax was imposed on net income at rates ranging from 1%, on a taxpayer's first $1,000 of taxable income, to 5%, for income amounts over $10,000. Just under $700,000 was collected from individuals during the first 18 months that the tax was in existence (January 1, 1933 to June 30, 1934). Within the next five years the tax collections from individuals had increased almost tenfold to about $6.2 million (fiscal year 1939). This $6.2 million represented approximately $2 of collections per capita.

By fiscal year 1984, individual income tax collections were just over $2.3 billion. This amount was 46.3% of net state tax collections and represents just over $550 per capita. All collections from this tax are deposited in the general fund of the state treasury.

Tax Base

For purposes of defining individual income tax expenditures, it is useful to note that the theoretical tax base for both the federal and state income tax is "net income"; that is, gross income from all sources less certain costs associated with earning the income. Thus, omissions from net income that were identified as being reasonable and necessary costs of earning income, were generally not considered, in this study, to be tax expenditures. While such a frame of reference does have ambiguities, it nevertheless provides a convenient definitional benchmark.

Minnesota's income tax calculation begins with "Federal Adjusted Gross Income" (FAGI). That amount is modified in a number of ways to arrive at "Minnesota Gross Income" (MGI). Since net income to be taxed is derived from MGI, it follows that all omissions from either FAGI or MGI which are not reasonable and necessary costs of earning income should be considered tax expenditures. It also follows that some individual income tax expenditures result from exclusions from FAGI, and that those are federally created. That is, while Minnesota generally has a choice in either following a federal exclusion or not, the original decision to create a preferential provision was made at the federal level. Other income exclusions, as might be expected, are unique to Minnesota. Finally, some income exclusions or deductions result from both federal and state provisions. This last type of tax expenditure occurs when, for example, under the federal income tax some type of income is completely omitted, while Minnesota requires a partial addback in computing MGI.

The tables on the following page show the computational steps in arriving at a Minnesota income tax amount, and the different points at which income tax expenditures may arise:

COMPUTATION OF MINNESOTA INDIVIDUAL INCOME TAX

	ECONOMIC INCOME (from all sources)
less :	Federal Exclusions
equals :	Federal Gross Income
less :	Federal Deductions
equals :	Federal Adjusted Gross Income (FAGI)
plus or minus :	Minnesota Adjustments
equals :	Minnesota Gross Income (MGI)
less :	Federal Income Tax Liability
equals :	Minnesota Adjusted Gross Income
less :	Personal Deductions (standard or itemized)
equals :	Minnesota Taxable Income
times :	Taxable Income Adjustment Factor
equals :	Minnesota Adjusted Taxable Income
times :	Graduated Rates (1.6% to 16%)
equals :	Minnesota Gross Tax
less :	Personal Credits
less :	Other Nonrefundable Credits
equals :	Minnesota Net Tax Before Surtax
plus :	Surtax (10% for 1983, 0% thereafter)
equals :	Minnesota Net Tax After Surtax
less :	Refundable Credits
equals :	Net Tax Due or Refund

As mentioned, some tax expenditures are the result of both federal and state provisions. On the other hand, some tax expenditures may be partially or completely offset by a unique state provision. In order to avoid showing related or offsetting provisions under which income is excluded or deducted as separate tax expenditures, the following conventions were followed:

Type of Federal and State Provision	Classification of Resulting Tax Expenditure	Example
1) Federal : Exclusion or Deduction State : No addback	Federal Exclusion or Deduction	Employee Meals and Lodging (item 1.01)
2) Federal : Exclusion or Deduction State : Partial addback	Federal Exclusion or Deduction (for net exclusion)	Individual Retirement Accounts (item 1.47)
3) Federal : Exclusion or Deduction State : complete addback	Not a tax expenditure (no net Minnesota exclusion or preference)	"All Savers" Interest Exclusion
4) Federal : Exclusion or Deduction State : Greater exclusion/ deduction	Minnesota Adjustment or Deduction (for entire exclusion)	Social Security Benefits (item 1.53)

Changes in federal law that were enacted during 1984 are not included in this report because the Minnesota Legislature has not yet had the opportunity to adopt or reject those changes.

After arriving at MGI, there are three additional steps in deriving the income amount that Minnesota taxes: 1) the deduction of federal income taxes; 2) personal deductions; and 3) the application of the taxable income adjustment factor.

The federal tax deduction is considered a tax expenditure in this report, item 1.54, because of its differential effect for taxpayers in like circumstances (due to the existence of tax expenditures at the federal level).

Personal deductions are either a standard deduction of ten percent of Minnesota Adjusted Gross Income (MGI less federal tax deduction) up to an indexed maximum of $2,300 for 1984, or separately itemized deductions. Minnesota itemized deductions are similar to those allowed federally with the exception of deductions for dependent education expenses, state income taxes, and a few differences for charitable contributions and adoption expenses. Because they confer preferential treatment to a subset of taxpayers, itemized deductions are included as tax expenditures. The standard deduction provision is included in this report, not because it is a preferential provision (equally situated taxpayers do receive equal treatment), but rather for informational purposes and because it may in some degree be viewed as a convenient proxy for a certain minimum level of itemized deductions.

Following the federal income tax deduction and personal deductions, the resulting Minnesota taxable income amount is adjusted by application of an adjustment factor. The factor, enacted as part of the 1981 amendments to indexing, adjusts taxable incomes upward in order to accommodate full bracket expansion in light of the deteriorating effect that the deduction of unindexed federal income taxes would otherwise have on Minnesota taxable incomes. In tax year 1984 the adjustment factor was 1.013.

Computation of Net Tax

Adjusted taxable incomes are subjected to a set of twelve graduated rates ranging from 1.6% to 16.0%, producing a gross tax amount. The indexed brackets to which these rates apply are shown below:

Statutory Brackets and Rates for
1984 Individual Income Taxes

Taxable Income		
Over	But Not Over	Tax Rate
$ 0	$ 690	1.6%
690	1,380	2.2
1,380	2,759	3.5
2,759	4,138	5.8
4,138	5,517	7.3
5,517	6,896	8.8
6,896	9,653	10.2
9,653	12,410	11.5
12,410	17,236	12.8
17,236	27,578	14.0
27,578	37,920	15.0
37,920		16.0

This schedule of rates results in average tax rates that increase as taxable incomes rise, since they are progressive with respect to that base. But because taxpayers with equal amounts of the tax base (adjusted taxable income) will have identical gross tax amounts, this study does not consider the graduated rates structure to be a tax expenditure.

The computed Minnesota gross tax amount is reduced by nonrefundable credits to arrive at net tax liability. Nonrefundable credits can be used only to the extent that gross tax exceeds zero — that is, they can only be used to reduce the net tax to zero, but not to create a refund.

A common nonrefundable credit is the personal credit which is available to taxpayers for themselves, their spouse and their dependents. The credit is an indexed amount of $70 for tax year 1984.

Refundable credits are those credits used to provide payments to taxpayers where the credit is in the nature of recognizing a prior payment. For example, the credit for taxes withheld is refundable because the state owes the taxpayer a credit for his withholding regardless of his gross tax amount. The exceptions to the prior payment principle are tax expenditures 1.85, 1.86, and 1.87. Obviously, as the term implies, refundable credits can be used in full even if the gross tax amount is less than the credit amount.

In 1982 and 1983 there was one additional step required in computing net tax liability, namely the surtax calculation. A surtax of seven percent for 1982 and ten percent for 1983 was applicable. The surtax was applied to the tax net of nonrefundable credits. Where appropriate, the impact of the surtax is included in the tax expenditure estimates.

Indexing

Minnesota adopted indexing in 1979 and modified the formula in 1981. Currently the maximum standard deduction, personal credits, and tax brackets are indexed to the lesser of consumer price index or MGI growth rates. In addition, the indexing formula includes the application of the taxable income adjustment factor, discussed above.

Because indexing was viewed as something that merely modifies other provisions of the tax structure, it is not treated as a separate tax expenditure provision in this study. The impact of indexing is included in the estimates for those tax expenditure items to which indexing applies.

Minnesota Minimum Tax

Since 1977, Minnesota has imposed a minimum tax on tax preference items, based on the federal alternative minimum tax. The provision insures that some tax is paid by taxpayers who have income, including tax preference items, above a certain amount. The minimum tax is in addition to any regular income tax to which the person may be subject.

The tax preference items subject to the federal alternative minimum tax include, among other things, the dividend exclusion, the all-savers exclusion, the capital gains deduction, and certain types of accelerated depreciation or amortization. Many of the tax preference items are also tax expenditures.

In estimating the fiscal impact of the tax expenditure items that are also items subject to the minimum tax, no adjustment is made to account for the fact that some of the cost is offset by the minimum tax. The apportionment of the minimum tax to the various items would be arbitrary. Even if an arbitrary apportionment were made, the adjustment to any item would not be large, because the total minimum tax is relatively small (under $4 million annually).

FEDERAL EXCLUSIONS

1.01 EMPLOYEE MEALS AND LODGING

Internal Revenue Code, Sections 119 and 107; Minnesota Statutes, Section 290.01, Subd. 20

Definition
I.R.C. Section 119 allows employees to exclude from federal gross income the value of meals and lodging provided in kind by their employers. This provision does not cover those instances when an employee is reimbursed by his employer for amounts previously spent on meals and lodging. Furthermore, in order to qualify for the exclusion, in kind services must be provided for the employer's convenience, and meals must be furnished on the employer's premises.

There is one major exception to the in kind qualification. Section 107 states that members of the clergy may exclude all housing allowances, regardless of whether they are in kind or in cash.

This exclusion was first allowed in 1918 by federal regulation. Section 119 was enacted in 1954 and last changed in 1981. Section 107 was enacted in 1954 and remains unchanged.

Fiscal Impact

FY 1984	$11,000,000*
FY 1985	12,000,000
FY 1986	12,000,000
FY 1987	13,000,000

1.02 MERCHANDISE DISTRIBUTED TO EMPLOYEES ON HOLIDAYS

Internal Revenue Service, Revenue Ruling 59-58; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
Employees are not required to include in federal gross income the value of gifts received from their employers on holidays, provided the gifts are of nominal value (generally $25 or less) and are not readily convertible to cash.

Revenue Ruling 59-58 was promulgated in 1959.

Fiscal Impact

FY 1984	$280,000*
FY 1985	270,000
FY 1986	290,000
FY 1987	300,000

1.03 EMPLOYEE DISCOUNTS

Section 801 of the Economic Recovery Tax Act of 1981; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Discounts provided by employers to their employees on the purchase of goods or services are excluded from the employees' federal gross incomes. This study views such discounts as a part of an employee's total compensation package. Because these discounts then represent untaxed income, they are a tax expenditure.

* Estimate includes 10% surcharge

Although employee discounts have never been subject to the state income tax, it was only in 1975 that the I.R.S. proposed regulations concerning the taxation of discounts. Congress reacted by temporarily blocking the issuance of regulations on employee discounts. In 1984, Congress enacted legislation which classifies discounts into exempt and nonexempt categories. However, because Minnesota has yet to update to those changes, all employee discounts remain excluded from income for Minnesota tax purposes.

Fiscal Impact

FY 1984	$5,100,000*
FY 1985	5,300,000
FY 1986	5,900,000
FY 1987	6,500,000

1.04 EMPLOYER EDUCATIONAL ASSISTANCE (REPEALED)

Internal Revenue Code, Section 127; Minnesota Statutes, Section 290.01, Subd. 20

Definition

Prior to 1978, only employer-provided educational assistance which was job related was excluded from federal gross income. In 1978 Congress enacted I.R.C., Section 127 which removed the distinction between job related and non-job related educational expenditures and allowed all employer-provided educational assistance to be excluded as long as the assistance is not available just to management, highly compensated employees, or to certain shareholders. Since exclusions from income of costs incurred which are necessary to earning an income are not tax expenditures (see introduction to this section), only exclusions for non-job related educational expenses are considered a tax expenditure. Under this provision, all costs of an employee's tuition, fees, books, supplies and equipment paid for by an employer are excluded from the employee's gross income.

The tax expenditure provision allowing for the exclusion of non-job related educational assistance from an employee's gross income was first enacted in 1978. It is set to expire at the federal level on December 31, 1983. Therefore, the study shows an impact for fiscal year 1984 only because it is assumed that Minnesota would adopt the expiration.

Fiscal Impact

FY 1984	$340,000*
FY 1985	None
FY 1986	None
FY 1987	None

1.05 EMPLOYER-PROVIDED CHILD CARE

Internal Revenue Code, Section 129; Minnesota Statutes, Section 290.01, Subd. 20

Definition

In general, the value of employer-provided child or dependent care, not exceeding an employee's earned income, is excluded from federal gross income. Amounts exceeding earned income are taxed. An employee is not eligible for this exclusion if he or she makes direct payments for child or dependent care, but in those cases the taxpayer may be eligible for the child and dependent care credit (item 1.85).

This provision was enacted by Congress in 1981 and is effective for tax year 1982 and following.

Fiscal Impact

FY 1984	$ 160,000*
FY 1985	470,000
FY 1986	720,000
FY 1987	1,000,000

* Estimate includes 10% surcharge

1.06 VALUE OF EMPLOYER-PROVIDED COMMUTER VEHICLES (REPEALED)

Internal Revenue Code, Section 124; Minnesota Statutes, Section 290.01, Subd. 20

Definition
The value to an employee of an employer-provided commuter vehicle which is used for transportation between an employee's residence and place of employment is excluded from the employee's gross income. However, a commuter vehicle must seat at least eight passengers to qualify. This provision is a tax expenditure only to the extent that the value of the vehicle received by the employee exceeds any fees or charges which the employee pays to the employer. In most cases employees are required to pay a per mile or monthly charge to at least partially compensate the employer for the cost of the commuting vehicle. On the average, 75% of an employer's costs are recovered in this way.

In 1976, the Minnesota Legislature enacted a similar provision which was in effect until tax year 1982. The federal provision became effective for tax years beginning after December 31, 1978. It is scheduled to expire for the tax years beginning after December 31, 1985.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	None

1.07 EMPLOYER CONTRIBUTIONS TO PREPAID LEGAL SERVICES PLANS (REPEALED)

Internal Revenue Code, Sections 120 and 501(c)(20); Minnesota Statutes, Section 290.01, Subd. 20

Definition
An employee may exclude from federal gross income the value of legal services or benefits received, provided such services or benefits are from a qualified group prepaid legal services plan established by his or her employer. The primary qualifying criterion for plans is that they be prepaid by the employer. For that reason, plans which reimburse employees for legal fees they may incur do not qualify for this exclusion. A second important criterion is that the plan must provide legal services to all employees equally and not just to certain management personnel, highly compensated employees, or certain shareholders.

This provision was enacted by Congress in 1976 and was extended in 1981. It is scheduled to expire December 31, 1984. Therefore, estimates are given only for fiscal years 1984 and 1985.

Fiscal Impact

FY 1984	$320,000*
FY 1985	290,000
FY 1986	None
FY 1987	None

1.08 EMPLOYER CONTRIBUTIONS TO PENSIONS AND PENSION EARNINGS

Internal Revenue Code, Sections 401-407, 410, and 415; Minnesota Statutes, Section 290.01, Subd. 20

Definition
All employer contributions to a qualified employee's pension plan are excluded from federal gross income. The earnings derived from such contributions, as well as those from contributions made by the employee, are also excluded from the employee's gross income. Strictly speaking, this provision represents a deferral of income and not an exclusion, since all pension income which was not previously subject to taxation must be included in federal gross income when disbursements are received. The estimates below show the fiscal impact of excluding current year pension contributions and earnings from taxable income, net of all taxed

* Estimate includes 10% surcharge

pension income which is disbursed in that year. For related discussions see items 1.47 and 1.48 (IRA and Keogh plans) and item 1.51 (Minnesota Pension Subtraction).

This exclusion was enacted by Congress in 1921. Minnesota has allowed this exclusion since 1933, adopting the federal language in 1961.

Fiscal Impact

FY 1984	$150,000,000*
FY 1985	140,000,000
FY 1986	160,000,000
FY 1987	170,000,000

1.09 EMPLOYER CONTRIBUTIONS FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

Internal Revenue Code, Sections 105 and 106; Minnesota Statutes, Section 290.01, Subd. 20

Definition

Employees may exclude from federal gross income all employer contributions made on their behalf to health insurance plans which provide compensation for sickness and injury. Employees may also exclude payments they receive from such plans to the extent that such payments are based on the nature of the injury or illness or the cost of medical care, and not based on the period the employee is absent from work. A self-employed person is not an employee for the purpose of this exclusion.

Employer contributions for medical insurance premiums and medical care have never been taxed in the United States. In 1943, an Internal Revenue Service ruling made this previously unwritten rule explicit for employer contributions to group health insurance policies. The 1943 ruling did not cover contributions to individual health insurance policies and a 1953 I.R.S ruling declared these to be taxable. I.R.C., Section 106 was enacted by Congress in 1954 to reverse the 1953 I.R.S. ruling making employer contributions to employee health and accident plans excludable from an employee's gross income. See item 1.10 for a related discussion.

Fiscal Impact

FY 1984	$140,000,000*
FY 1985	140,000,000
FY 1986	160,000,000
FY 1987	190,000,000

1.10 EMPLOYER-PAID ACCIDENT AND DISABILITY PREMIUMS

Internal Revenue Code, Section 106; Minnesota Statutes, Section 290.01, Subd. 20

Definition

Employees may exclude from federal gross income premiums for accident and disability insurance which are paid for by their employers. Employees may also exclude some of the payments they receive from such insurance plans (see item 1.16). The tax expenditure measures the exclusion of the premium payments from wages or other taxable compensation.

Section 106 was enacted by Congress in 1954. See item 1.09 for a related discussion.

Fiscal Impact

FY 1984	$1,000,000*
FY 1985	1,000,000
FY 1986	1,000,000
FY 1987	1,000,000

* Estimate includes 10% surcharge

1.11 EMPLOYER-PAID GROUP TERM LIFE INSURANCE PREMIUMS

Internal Revenue Code, Section 79; Minnesota Statutes, Section 290.01, Subd. 20

Definition
An employee may exclude from federal gross income all group term life insurance premiums paid on his behalf by an employer. However, this exclusion applies only to premiums paid for insurance coverage of $50,000 or less; additional premiums for coverage in excess of $50,000 must be included in an employee's gross income. Several requirements which must be met for plans to qualify for this tax treatment have been amended, effective January 1, 1984. The chief among them being that the plan cannot discriminate in favor of certain employees, such as highly compensated persons or senior management personnel.

In 1920 a federal administrative legal opinion was issued authorizing this exclusion. In 1954 when the Internal Revenue Code was revised, the provision was formally placed in the Code as Section 79. The last substantive change to this provision became effective beginning with tax year 1984.

Fiscal Impact

FY 1984	$19,000,000*
FY 1985	19,000,000
FY 1986	21,000,000
FY 1987	23,000,000

1.12 INCOME EARNED ABROAD BY U.S. CITIZENS AND EMPLOYER-PAID FOREIGN HOUSING COSTS

Internal Revenue Code, Sections 911 and 912; Minnesota Statutes, Section 290.01, Subd. 20

Definition
United States citizens or residents who have their principal residence in a foreign country, and who are either present overseas for 11 out of 12 consecutive months or who are bona fide residents of a foreign country may exclude from federal gross income the income which is earned in foreign countries up to a maximum amount. The maximum exclusion increases each year, with $80,000 being allowed in tax year 1983, $85,000 in 1984, $90,000 in 1985, and $95,000 allowed in 1986. This exclusion does not apply to federal employees, including members of the Armed Forces. The taxpayer may also exclude from federal gross income employer-paid foreign housing costs. For a related discussion see item 1.49 (Foreign Housing Costs Paid by Taxpayer).

Income earned abroad by United States citizens was first excluded from federal gross income in 1926. The last changes made to this provision were enacted by Congress in 1981.

Fiscal Impact

FY 1984	$2,300,000*
FY 1985	2,200,000
FY 1986	2,300,000
FY 1987	2,500,000

1.13 BENEFITS AND ALLOWANCES TO ARMED FORCES PERSONNEL

Internal Revenue Code, Sections 112 and 113; Internal Revenue Service, Regulation 1.61-2; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000; and court decisions

Definition
This tax expenditure contains the following items:

* Estimate includes 10% surcharge

1. Combat pay: I.R.C., Section 112 excludes all combat pay, provided military personnel are serving in a combat zone designated as such by an executive order. If military personnel are hospitalized as a result of wounds or disease while serving in a designated combat zone, their combat pay will be excluded for up to two years after the termination of combat activities in the zone. There is no dollar limit on this exclusion for enlisted personnel, but there is a $500 per month limitation for officers.

2. Mustering-out (Discharge) pay: I.R.C., Section 113 excludes all amounts specifically designated as mustering-out pay. However, other lump-sum payments received upon separation from service or release to inactive duty which are not designated as mustering-out pay are taxable.

3. In kind and other benefits: I.R.S. Regulation 1.61-2 and several court decisions exclude a number of different benefits provided to military personnel on an in kind basis. Also, under certain circumstances cash allowances provided in lieu of in kind benefits may be excluded from gross income. Payments for quarters, food, subsistence, and variable housing allowances are examples of such benefits.

The exclusion of benefits and allowances to Armed Forces personnel was first enacted into law by Congress in the 1942 Revenue Act. The law remains substantially unchanged since then.

Fiscal Impact

FY 1984	$6,000,000*
FY 1985	5,600,000
FY 1986	6,000,000
FY 1987	6,300,000

1.14 VETERANS' BENEFITS ADMINISTERED BY THE VETERANS ADMINISTRATION

38 United States Code 3101; Minnesota Statutes, Section 290.01, Subd. 20

Definition

All benefits administered by the Veterans Administration (V.A.) are excluded from a taxpayer's federal gross income under federal law. V.A. benefits may be divided into three categories:

1. compensation for service-connected disability or death;
2. pensions for non-service-connected disability or death; and
3. vocational rehabilitation, education, and training assistance (commonly referred to as G.I. Bill benefits).

Compensation for service-related disability or death is based solely on the degree of impairment or injury, without regard to income or wealth. Pensions for non-service-related disabilities are determined according to how much income a veteran has; as income becomes larger, fewer benefits are awarded. G.I. Bill benefits, including readjustment, rehabilitation, and educational assistance programs, are awarded according to the type of training received, time enrolled in training program, marital status and number of dependents.

V.A. benefits have never been taxed, having first been excluded from federal gross income by Congress in 1917.

Fiscal Impact

	Disability Compensation	Pensions	G.I. Bill	Total
FY 1984	$22,900,000*	$6,200,000*	$3,500,000*	$32,600,000*
FY 1985	22,700,000	5,700,000	3,100,000	31,500,000
FY 1986	24,800,000	6,200,000	2,500,000	33,500,000
FY 1987	27,100,000	6,800,000	2,100,000	36,000,000

* Estimate includes 10% surcharge

1.15 MILITARY DISABILITY PENSIONS

Internal Revenue Code, Sections 104(a)(4) and 104(b); Minnesota Statutes, Section 290.01, Subd. 20

Definition
Retired military personnel who have at least a thirty percent disability may receive a pension from the Department of Defense based on either number of years in service or their percent disability, whichever would produce a larger pension. The amount of pension which would be awarded the retiree based on percent disability may be excluded from federal gross income. However, only qualified pensions may be excluded. For retirees who entered military service on or before September 24, 1975, qualified pensions include all those awarded for personal injury and illness resulting from active service in the armed forces of any country. For retirees entering service after September 24, 1975, only those pensions awarded for combat-related injuries qualify.

Military disability pensions were first excluded from federal gross income by Congress in 1942. The last major change to this provision occurred in 1976.

Fiscal Impact

FY 1984	$620,000*
FY 1985	580,000
FY 1986	590,000
FY 1987	610,000

1.16 DISABILITY PAY (REPEALED)

Internal Revenue Code, Section 105(d); Minnesota Statutes, Section 290.01, Subd. 20

Definition
Individuals under the age of 65 who have retired and who are permanently and totally disabled are entitled to an exclusion from income of qualified disability payments. The maximum exclusion is $100 per week ($5,200 per year). These payments must be received by employees under accident and health plans financed wholly or in part by employers; those who are self-employed do not qualify. Additionally, the excludable amount must be reduced on a dollar-for-dollar basis by the amount by which the taxpayer's (or couple's) adjusted gross income (excluding disability income) exceeds $15,000.

This exclusion affects only fiscal year 1984 because Congress repealed this provision for all tax years beginning after December 31, 1983. Minnesota adopted the federal repeal in 1984. However, this adopted repeal will not necessarily result in disability pay being included in Minnesota gross income beginning with 1984 tax year. The state will allow disability pay to remain untaxed under Minnesota Statutes, Section 290.01, Subd. 20b(6). (See individual income tax expenditure item 1.51. Estimates for item 1.51, "Pension, Retirement or Severance Income," have been adjusted to include the effect of this repeal.)

Disability pay was first excluded from federal income tax by the 1918 Revenue Act. In 1954 Congress adopted the current Internal Revenue Code, expanding the scope of this provision in the process. The federal Tax Reform Act of 1976 restricted the provision somewhat. The 1983 Congressional repeal was adopted by the Minnesota Legislature in 1984.

Fiscal Impact

FY 1984	$1,800,000*
FY 1985	None
FY 1986	None
FY 1987	None

* Estimate includes 10% surcharge

1.17 SPECIAL BENEFITS FOR DISABLED COAL MINERS

Internal Revenue Code, Section 104(a)(1); 30 United States Code 801; Internal Revenue Service, Revenue Ruling 72-400; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
Payments made by certain federal programs to coal miners, their dependents, or survivors because of a death or disability resulting from black lung disease (pneumoconiosis) are excluded from the recipients' federal gross income. Taken by themselves, the benefits paid out by these programs are too low for a taxpayer to incur any tax liability. However, it is likely that many recipients have additional sources of income which raise their incomes to taxable levels. Even so, the impact on the state for this provision is very small.

Disability payments for black lung disease were first specifically excluded from federal gross income by the Black Lung Benefits Act of 1972. Payments received after December 31, 1972, were excluded from income by I.R.S. Revenue Ruling 72-400 because the benefits are classified as workers' compensation.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

1.18 WORKERS' COMPENSATION BENEFITS

Internal Revenue Code, Section 104(a)(1); Minnesota Statutes, Section 290.01, Subd. 20

Definition
All workers' compensation benefits are excluded from federal gross income. However, only a part of this exclusion represents a tax expenditure.

There are three basic types of workers' compensation benefits: 1) payments for medical or rehabilitation expenses; 2) compensation for permanent disabilities; and 3) replacement of lost wages. If payments which reimburse the injured worker for medical or rehabilitation expenses were included in gross income for tax purposes, corresponding deductions would arise to largely negate the impact of the inclusion. The exclusion of compensation for permanent disability was not deemed to be a tax expenditure because it was assumed that these payments are intended to compensate the injured worker for a loss, and are therefore not "income" to the recipient. Accordingly, the estimates below measure the impact of excluding just that portion of workers' compensation benefits which represents income replacement for the injured workers.

Workers' compensation benefits were first excluded from federal taxation in 1918, and from state taxation in 1933.

Fiscal Impact

FY 1984	$17,000,000*
FY 1985	18,000,000
FY 1986	20,000,000
FY 1987	23,000,000

1.19 CASH PUBLIC ASSISTANCE

Numerous Internal Revenue Service Revenue Rulings; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
This tax expenditure measures the fiscal impact for the exclusion from federal gross income of only those

* Estimate includes 10% surcharge

public assistance programs which award benefits in the form of cash payments. The following programs, funded in various combinations by federal, state and county sources, are included in the estimates: Aid to Families with Dependent Children (AFDC); General Assistance; Emergency Assistance; Minnesota Supplemental Aid; and Supplemental Security Income. Many people who receive these benefits would pay no tax even if this tax expenditure provision were repealed because their incomes would fall below the minimum taxable income. Accordingly, the estimates include only that small percentage of recipients whose income would be raised to a taxable level.

This exclusion has no direct statutory basis. Public assistance benefits have instead been excluded from income by a series of I.R.S. Revenue Rulings. Revenue rulings are issued to provide interpretations of substantive tax law. They do not have the force or effect of law, nor even of regulation, but they are relied on in the day-to-day administration of tax laws and are often referred to by the courts. During the 1930's the I.R.S. issued a series of Revenue Rulings on the definition of federal gross income which explicitly exclude these benefits.

Fiscal Impact

FY 1984	$2,000,000*
FY 1985	1,900,000
FY 1986	2,200,000
FY 1987	2,600,000

1.20 GIFTS

Internal Revenue Code, Section 74(b), 101(b), 102, and 117; Internal Revenue Service, Regulation 1.74-1; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
The value of all property which is received by gift is excluded from federal gross income. For tax expenditure purposes, gifts may be broken down into the following three categories:

1. Prizes and Awards — In order to be tax exempt, prizes and awards must be received primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civil achievement, and the recipient must not be required to render substantial future services as a condition of receiving the prize or award.
2. Scholarship and Fellowship Income — All qualified amounts received by degree candidates may be excluded from gross income. Also, nondegree students may exclude up to $300 of scholarship and fellowship income received per month.
3. Other Gifts — The fair market value of all property received in the form of a gift is excluded from the recipient's gross income. Excluded as a gift is up to $5,000 of employer-paid death benefits received by a taxpayer. Inheritances and bequests, as a form of gifts, are also excluded from gross income by this provision. However, inheritances and bequests are not included in the estimates below because they are subject to the Minnesota estate tax.

Gifts have not been subject to the income tax in Minnesota since 1933. Minnesota enacted a gift tax in 1937 and repealed it in 1979. In 1954, Congress first enacted legislation designating which prizes, scholarships, and fellowships were excluded from federal gross income.

Fiscal Impact

	Prizes	Scholarship and Fellowship Income	Other Gifts	Total
FY 1984	$ 90,000*	$ 9,000,000*	$ 6,500,000*	$15,590,000*
FY 1985	90,000	8,700,000	6,100,000	14,890,000
FY 1986	90,000	9,600,000	6,400,000	16,090,000
FY 1987	90,000	10,100,000	6,800,000	16,990,000

* Estimate includes 10% surcharge

1.21 LIFE INSURANCE

Internal Revenue Code, Section 101(a); Treasury Regulation 1.451-2; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
The current treatment of life insurance policies may be broken down into two components. The first benefits the policyholder, and the second benefits the recipient of life insurance proceeds.

The first component is the exclusion of the interest on life insurance savings. Premiums paid, especially those in the early years of a policy, are often greater than the actual cost of insurance. The excess premiums are invested and earn interest for the policyholder. These earnings are not taxed when earned and are only partially taxed if paid out during the policyholder's lifetime. This deferral and exclusion represents a tax expenditure.

The second component is the exclusion of life insurance proceeds when they are paid out. If proceeds are paid to the policyholder prior to death, these "living benefits" are interest (discussed above) and a return of capital. The exclusion of the portion of proceeds representing a return of capital is not a tax expenditure. However, when someone other than the policyholder is the recipient of life insurance proceeds, the entire amount paid out is similar to a gift. To the extent that these types of proceeds are not taxed under the estate tax, their exclusion from taxable income represents a tax expenditure.

Life insurance interest earned and proceeds paid out have been excluded from taxable income since the income tax laws were enacted in 1933. This provision was last changed in 1983.

Fiscal Impact

	Interest Portion	Gift Portion	Total
FY 1984	$42,000,000*	$16,000,000*	$58,000,000*
FY 1985	42,000,000	16,000,000	58,000,000
FY 1986	46,000,000	18,000,000	64,000,000
FY 1987	51,000,000	19,000,000	70,000,000

1.22 DIVIDENDS

Internal Revenue Code, Section 116; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Taxpayers may exclude from federal gross income the first $100 of qualifying dividends received during the tax year. Those filing joint or combined returns may exclude up to $200 regardless of which spouse receives the dividend income. Qualifying dividends include those from taxable domestic corporations, cooperatives, and insurance companies. Nonqualifying dividends include those from foreign corporations, tax-exempt organizations, and amounts paid or credited by mutual savings banks, building and loan associations, and similar institutions, to the accounts of depositors as dividends on their deposits.

Separate rules apply to fiduciary taxpayers. An estate or trust may claim only that portion of the $100 exclusion equal to taxable income divided by gross income. Therefore, if only half of an estate's gross income is taxable, a maximum of $50 of dividends received may be excluded from federal gross income.

This provision was first enacted by Congress in 1954. In 1964 the maximum exclusion amount was raised from $50 to $100. The provision remains substantially unchanged since then.

Fiscal Impact

FY 1984	$4,900,000*
FY 1985	4,400,000
FY 1986	4,400,000
FY 1987	4,400,000

* Estimate includes 10% surcharge

1.23 REINVESTMENT OF DIVIDENDS IN PUBLIC UTILITY STOCK (REPEALED)

Internal Revenue Code, Section 305(e); Minnesota Statutes, Section 290.01, Subd. 20

Definition
Taxpayers who own stock in a qualified domestic utility company and choose to receive their dividends in qualified common stock by means of an approved dividend reinvestment plan may exclude the dividends so received from federal gross income. The maximum exclusion is $750 per year ($1,500 on joint returns). This tax expenditure can be broken down into two distinct parts: 1) a deferral, and 2) a conversion. The deferral is considered a tax expenditure because of the time value of money. Normally dividends are included in gross income in the year in which they are received. By allowing certain taxpayers to take their cash dividends in the form of stock, a portion of their tax liability is deferred until the stock is sold. When the stock is sold, the conversion portion of the tax expenditure occurs. As long as the sale occurs more than one year from the dividend distribution date, the reinvested dividend income is treated as a long-term capital gain and only partially included in taxable income. (For a related discussion, see item 1.28.)

This provision was added to the Internal Revenue Code by the Economic Recovery Act of 1981. It is scheduled to expire after December 31, 1985. For this reason no impact is estimated for fiscal year 1987.

Fiscal Impact

FY 1984	$3,300,000*
FY 1985	3,400,000
FY 1986	5,000,000
FY 1987	None

1.24 NET INTEREST EXCLUSION

Internal Revenue Code, Section 128; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Beginning with tax year 1985, taxpayers may exclude from federal gross income fifteen percent of net interest income received in a taxable year, up to a maximum interest amount of $3,000 ($6,000 for joint filers). Net interest is defined as eligible interest received in excess of nonmortgage interest expense claimed as an income tax deduction (excluding business interest). Eligible interest includes interest from banks, savings institutions insured under law, government debts, trusts established under federal law, and indebtedness of domestic corporations and insurance companies.

This federal provision was enacted in 1981 and adopted by the state that same year. Although it was to be effective for tax years 1985 and thereafter, this provision was repealed at the federal level before it took effect. Minnesota has not yet adopted that repeal.

Fiscal Impact

FY 1984	None
FY 1985	None
FY 1986	$15,000,000
FY 1987	25,000,000

1.25 INTEREST ON GENERAL PURPOSE STATE AND MUNICIPAL DEBT

Internal Revenue Code, Section 103; Minnesota Statutes, Sections 290.01, Subd. 20 and Subd. 20a(1)

Definition
Generally all interest income received or accrued by a taxpayer during the taxable year is included in federal gross income. However, I.R.C., Section 103 allows a taxpayer to exclude from federal gross income interest received or accrued from all state and municipal general obligation bonds. This tax expenditure includes

* Estimate includes 10% surcharge

bonds which, in contrast to those described in item 1.26, are backed by the full faith and credit of the government which issues them.

Minnesota, like most states, disallows this exclusion if the interest is derived from bonds of non-Minnesota governmental units. Section 290.01 of the Minnesota Statutes requires taxpayers to add back all interest from other states which was excluded from federal income. The result is that only interest from bonds issued by the State of Minnesota or from Minnesota governmental units or municipalities is excluded from Minnesota gross income.

The federal government first excluded the interest from state and local bonds from gross income in 1913. Minnesota first exempted interest from Minnesota state and local bonds in 1933. When the state began adopting the federal definition of gross income in 1961, the add-back provision was included in the statutes to maintain the intent and effect of the 1933 law.

Fiscal Impact

FY 1984	$43,000,000*
FY 1985	43,000,000
FY 1986	45,000,000
FY 1987	48,000,000

1.26 INTEREST ON NONGUARANTEED STATE AND MUNICIPAL DEBT

Internal Revenue Code, Section 103; Minnesota Statutes, Section 290.01, Subd. 20 and 20a(1)

Definition

Generally all interest income received or accrued by a taxpayer during the taxable year must be included in federal gross income. However, interest from the following state and local bonds are excluded:

- Industrial development bonds (IDB's), I.R.C., Section 103(b).
- IDB's for mass transit, I.R.C., Section 103(b), 168.
- IDB's for energy facilities, I.R.C., Section 103 as amended by Section 241-244 of P.L. 96-223.
- IDB's for pollution control equipment, I.R.C., Section 103(b)(4)(F).
- Student loan bonds, I.R.C., Section 103(a)(2).
- Hospital bonds, I.R.C., Section 103(a) and (b) and Revenue Ruling 63-20.
- Housing bonds for owner-occupied housing, I.R.C., Section 103A.
- Housing bonds for rental housing, I.R.C., Section 103(b)(4)(A) and 42 U.S.C., Section 1437 (i)(b).
- Other miscellaneous bonds.

This tax expenditure is identical to individual income tax item 1.25 (above); except that the bonds covered here, even though issued by a government unit and allowed a tax-free interest status, are not backed by the full faith and credit of the issuing government. A state or municipal government is not legally responsible for repayment of the principal or interest of these bonds should the fund, agency, business entity, or individual responsible for repayment default. Congress is currently considering restricting the federal tax-free status of these bonds.

As was the case in item 1.25, only interest from Minnesota state and local bonds is excluded from Minnesota gross income. All interest from non-Minnesota bonds is added to federal adjusted gross income in determining Minnesota gross income.

The federal government first excluded interest from all forms of state and local bonds in 1913. Industrial revenue bonds in particular were first issued by the State of Mississippi in 1936, and even though they were not legally a debt to Mississippi, the I.R.S. ruled that, for tax purposes, the bonds did qualify as a debt of the government. In 1968 Congress restricted the tax-free status given interest of industrial revenue bonds to only those issued for certain specific purposes (including those listed above). Minnesota first exempted interest from Minnesota state and local bonds in 1933. When the state began adopting the federal definition of gross income in 1961, the add-back provision was included in the statutes to maintain the intent and effect of the 1933 law.

* Estimate includes 10% surcharge

Fiscal Impact	
FY 1984	$ 71,000,000*
FY 1985	77,000,000
FY 1986	92,000,000
FY 1987	104,000,000

1.27 CERTAIN AGRICULTURAL COST-SHARING PAYMENTS

Internal Revenue Code, Sections 126 and 1255; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Farmers may elect to exclude from federal gross income payments received from federal or state governments which are intended to help defray the costs of certain improvements made to the land. Qualifying payments include those made to:

1. conserve soil and water resources;
2. protect or restore the environment;
3. improve forests; and
4. provide a habitat for wildlife.

No deductions, depreciation, amortization, depletion, or investment credit may be claimed with respect to any such amount excluded from federal gross income. The estimates below represent the revenue impact of the exclusion provision over the alternative deduction allowed if improvements were capitalized.

This provision was enacted by Congress in 1978 and was last changed in 1980.

Fiscal Impact	
FY 1984	$1,100,000*
FY 1985	930,000
FY 1986	700,000
FY 1987	580,000

1.28 SIXTY PERCENT CAPITAL GAINS EXCLUSION (OTHER THAN HOMES, AGRICULTURAL, COAL, TIMBER, AND IRON ORE)

Internal Revenue Code, Sections 1201—1254; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Sixty percent of a taxpayer's net long-term capital gains may be excluded from federal gross income. Although no concise definition of "capital asset" exists, generally speaking, investments are capital assets for tax purposes, and inventory held for retail sale is not. A net long-term capital gain occurs when sales or exchanges within a tax year result in an excess of long-term capital gains (net of any long-term capital losses) over short-term capital losses (net of any short-term capital gains). With some exceptions, capital assets must be held a minimum of 12 months in order to receive the 60% deduction. (It should be noted that this minimum time period has been reduced to six months for federal tax purposes.) This estimate does not include deductions for capital gains from sales of most residential, agricultural, coal, timber and iron ore properties. (These are granted special treatment and dealt with in items 1.29, 1.30, 1.31, 1.32, 1.33, and 1.34.)

Capital gains income was first given preferential treatment federally in 1921. In 1945 Minnesota first allowed a deduction from state taxable income of 50% of net capital gains received from assets held more than six months. When the state began adopting the federal definition of adjusted gross income in 1961, the federal treatment was identical to the state treatment, and no substantive changes occurred. For tax year 1977, the minimum holding period was increased to nine months, and for tax years 1978 and beyond, it was raised to 12 months. For tax years beginning after October 31, 1978, the 50% deduction was expanded federally to

* Estimate includes 10% surcharge

the current 60% level. Minnesota raised the deduction to 60% in 1982 for long-term gains from all assets sold after December 31, 1982.

Fiscal Impact

FY 1984	$210,000,000*
FY 1985	200,000,000
FY 1986	220,000,000
FY 1987	230,000,000

1.29 CAPITAL GAINS TREATMENT OF CERTAIN AGRICULTURAL INCOME

Internal Revenue Code, Sections 1201, 1202, 1221 - 1223, 1231, 1245, 1251, and 1252; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Certain farm assets which normally would be treated as inventory are deemed to be long-term capital assets. The proceeds from the disposition of these assets are granted the 60% capital gains exclusion, provided the assets have been held a specified minimum amount of time. This represents a tax expenditure insofar as tax law would otherwise require the income received from their sale to be included in federal gross income as regular income. This special capital gains treatment is granted to both farm land and those assets referred to as "Section 1231 property." Section 1231 property, as defined in the I.R.C., includes orchards, vineyards, and livestock used for breeding, draft, dairy, or sporting purposes.

This capital gains treatment for certain agricultural income was first enacted by Congress in 1951. The last changes affecting this tax expenditure were made in 1983.

Fiscal Impact

FY 1984	$13,000,000*
FY 1985	12,000,000
FY 1986	13,000,000
FY 1987	14,000,000

1.30 CAPITAL GAINS TREATMENT OF CERTAIN TIMBER INCOME

Internal Revenue Code, Sections 631(a), 631(b), 1221, and 1231; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Taxpayers receiving timber income from the following three sources may claim the 60% capital gains deduction (thereby including only 40% of the timber income in federal gross income):

1. Non-business occasional sales. Similar to other non-business sales, income from timber sales occurring outside the course of normal business is treated as a long-term capital gain.
2. Lease arrangements. Similar to the treatment of royalty payments for mineral rights, when a taxpayer leases the rights to cut timber on a tract of land, payments received (less any depletion allowance claimed) are considered long-term capital gains.
3. Timber used in trade or business. Timber which has appreciated in value may (for tax purposes) be treated as having been sold at the time it is cut down, even though the felling of the timber occurs in the normal course of business, and even though no sale or transaction takes place. The capital gain is the current estimated value of the timber less the taxpayer's basis.

Only income received from sources (2) and (3) are included in this estimate. Source (1) income is included in item 1.28 (Capital Gains Other Than Homes, Agriculture, Coal, Timber, and Iron Ore).

* Estimate includes 10% surcharge

The provisions allowing capital gains deductions for (2) and (3) were enacted by Congress in 1951. The last substantive change to these laws took place in 1983.

Fiscal Impact

FY 1984	$1,100,000*
FY 1985	1,100,000
FY 1986	1,400,000
FY 1987	1,600,000

1.31 CAPITAL GAINS TREATMENT OF IRON ORE ROYALTIES

Internal Revenue Code, Sections 631 (c) and 1231 (b); Minnesota Statutes, Section 290.01, Subd. 20

Definition

If an owner of an iron ore mineral interest disposes of his interest through a long-term lease arrangement, with royalty payments made to the owner based on the amount of ore mined per year, he may claim the 60% capital gains exclusion as through it were an outright sale. This is so even though the royalties are very similar to rent, and the sale can be said to be a lease. Also, even though the seller (i.e., the owner) is treated as having received purchase payments, the buyer is treated as a lessee for tax purposes and allowed to deduct royalties paid as though they were rent payments. The estimates below are a measure of the effect of the 60% capital gains exclusion being allowed on these transactions.

Capital gains treatment for these lease arrangements was first allowed by Congress in 1964. The provision was last revised in 1976.

Fiscal Impact

FY 1984	$3,200,000*
FY 1985	2,900,000
FY 1986	2,900,000
FY 1987	2,900,000

1.32 CAPITAL GAINS TREATMENT OF COAL ROYALTIES

Internal Revenue Code, Sections 631(c) and 1231(b); Minnesota Statutes, Section 290.01, Subd. 20

Definition

Under certain circumstances an owner of coal mining rights may claim the 60% capital gains deduction for income received from the disposal of those rights. This special treatment is allowed when the owner enters into a long-term lease agreement where royalty payments are paid to him based on the amount of coal mined during the year. The capital gains eligible for the deduction are equal to the royalty payments received, less any depletion allowance claimed for the tax year. Without this provision royalty payments would be treated as rent payments and would be fully included in federal gross income.

This provision was first enacted into federal law in 1951.

Fiscal Impact

FY 1984	$640,000*
FY 1985	640,000
FY 1986	700,000
FY 1987	760,000

* Estimate includes 10% surcharge

1.33 SPECIAL TREATMENT OF CAPITAL GAINS ON HOME SALES

Internal Revenue Code, Sections 121 and 1034; Minnesota Statutes, Section 290.01, Subd. 20

Definition

A taxpayer may exclude from federal gross income the capital gains received from the sale of his principal residence, provided he buys a replacement residence of equal or greater value within two years of the sale. There are two distinct components to this tax expenditure: a deferral and an exclusion. A deferral occurs because eventually the capital gain from the terminal sale (when no replacement purchase is made) will be subject to income taxation. Further, there are two primary ways this deferral may be converted into a permanent exclusion. One way, not dealt with here, occurs when the owner of the home dies. (Estimates for the exclusion of capital gains at death are provided in item 1.34). The second way in which a deferral may be converted into an exclusion is when a taxpayer 55 years of age or older sells his principal residence and takes a once-in-a-lifetime exclusion of up to $125,000 of capital gains realized from the sale. Capital gains which were actually realized from previous home sales but deferred for tax purposes may thus be totally excluded from taxable income. Because the deferral and this exclusion are related, they are presented here together with separate estimates shown for each portion.

The fiscal impact estimates for both the deferral and the exclusion portion of this item measure the difference between current treatment and what would be the case if 100% of the gain from homes sales were included in taxable income. The fiscal impact of non-home capital gains exclusions is found in items 1.28 through 1.34.

Congress enacted the deferral provision (Section 121) in 1951. The exclusion provision (Section 1034) was enacted by Congress in 1964. Both provisions were last revised in 1981.

Fiscal Impact

	Deferral of Capital Gains on Home Sales	Exclusion of Capital Gains — Age 55 or Older	Total
FY 1984	$43,000,000*	$14,000,000*	$57,000,000*
FY 1985	45,000,000	15,000,000	60,000,000
FY 1986	48,000,000	16,000,000	64,000,000
FY 1987	52,000,000	17,000,000	69,000,000

1.34 CAPITAL GAINS AT DEATH

Internal Revenue Code, Sections 1001, 1002, 1014, 1015, 1023, 1221 and 1222; Minnesota Statutes, Section 290.01, Subd. 20.

Definition

When property is transferred at death by inheritance or devise, any accumulated gain is not subject to income tax. The deceased's capital gains are forgiven, with the recipient's basis being the value of the assets at the time of the deceased's death. The estimates of this tax expenditure measure the difference between the current special treatment and what would be the case if 100% of the deceased's accumulated gains were included in the recipient's federal gross income.

Congress first excluded capital gains at death from income taxation in 1921. A similar provision was also incorporated into the original Minnesota income tax law in 1933.

Fiscal Impact

FY 1984	$30,000,000*
FY 1985	31,000,000
FY 1986	34,000,000
FY 1987	38,000,000

* Estimate includes 10% surcharge

1.35 INCOME FROM THE DISCHARGE OF DEBT

Internal Revenue Code, Sections 108 and 1017; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Section 108 of the Internal Revenue Code states that, in general, income from the cancellation of a debt is taxable. However, income which results from a taxpayer being allowed to pay off a debt for less than the originally agreed upon and legally required amount may be excluded from gross income under certain circumstances.

An exclusion is allowed if the discharge of debt occurs when the taxpayer is insolvent (i.e., liabilities exceed market value of total assets), and the following three criteria are met:

1. The person to whom the money is owed voluntarily agrees to forgive the debt;
2. The debtor can prove he or she was insolvent at the time the debt was forgiven; and
3. The person to whom the money is owed does not claim the bad debt loss on his or her taxes.

When all of these criteria are met, the taxpayer may exclude all of the income gained up to, but not exceeding, the amount by which he or she was insolvent. For example, if liabilities exceed assets by $5,000, up to $5,000 worth of discharged debt income is excludable from gross income.

Minnesota first provided this exclusion in 1943. Since 1961 Minnesota law has been updated to conform to Section 108 of the I.R.C. on an annual basis.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

1.36 AUTOMOBILE OWNERS' CAR POOL RECEIPTS

Internal Revenue Service, Revenue Ruling 55-555; Minnesota Statutes, Sections 290.01, Subd. 20 and 290.08, Subd. 23; Minnesota Rules, Part 8001.9000

Definition
An automobile owner operating a car pool may exclude from federal gross income money received from riders in the form of fares or reimbursements. Only that money received which is in excess of the costs incurred by the owner in operating the car pool is considered a tax expenditure. Essentially, all profit which a car pool operator is allowed to exclude is a tax expenditure. However, few car pool operators collect enough in fares to exceed their actual costs, and so this provision has little fiscal impact.

Car pool receipts were first officially excluded from gross income in 1955 with I.R.S. Revenue Ruling 55-555.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

* Estimate includes 10% surcharge

FEDERAL DEDUCTIONS

1.37 DEPRECIATION

Internal Revenue Code, Section 168; Minnesota Statutes, Section 290.01, Subd. 20 and Subd. 20f

Definition
Minnesota taxpayers are allowed a deduction for depreciation of property (other than land) used in a trade or business or held for the production of income. Depreciation is an attempt to measure an asset's decline in value due to use, wear, or decay within the tax year. The deduction is intended to match current expenses with current income. Conceptually, the tax expenditure is the extent that depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. The estimates below measure the extent to which current depreciation allowances exceed actual declines in value as measured by 35 year straight line depreciation for real property and class life asset depreciation ranges (CLADR) for personal property.

The depreciation deduction was a part of the original Minnesota income tax in 1933. Accelerated depreciation was first allowed through administrative practice by the federal government in 1946 and by law in 1954. Minnesota first enacted an accelerated depreciation provision in 1959. The last change to the state's provision occurred in 1984.

Fiscal Impact

FY 1984	$ 8,300,000*
FY 1985	11,000,000
FY 1986	21,000,000
FY 1987	29,000,000

1.38 AMORTIZATION OF BUSINESS START-UP COSTS

Internal Revenue Code, Section 195; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Individual taxpayers, who incur certain business start-up expenditures and subsequently enter the trade or business to which these costs relate, may elect to amortize these expenses over a period of not less than 60 months, beginning with the month in which the business commences. The following two types of start-up costs qualify for this treatment:

1. investigatory expenditures associated with investigating the creation or acquisition of a business prior to taking possession of the business; and
2. business creation costs incurred after the taxpayer decides to establish the business but before operations begin.

Without this special provision business start-up costs would be capitalized by adding them to the taxpayer's basis in the business. They would then be treated as nondepreciable intangible assets, with costs not being recoverable until the business is sold.

Congress first allowed this special treatment of start-up costs in 1980. The provision has not since been revised or amended.

Fiscal Impact

FY 1984	$1,000,000*
FY 1985	1,400,000
FY 1986	2,000,000
FY 1987	2,700,000

* Estimate includes 10% surcharge

1.39 AMORTIZATION OF MOTOR CARRIER OPERATING RIGHTS

Internal Revenue Service Regulation 1.9200-1; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
Motor carrier firms must have an operating authority to gain entry into the interstate motor carrier business. Prior to the Motor Carrier Act of 1980, the number of such operating authorities issued by the federal government was greatly limited. New firms wishing to obtain an operating authority generally had to purchase one from an existing firm. Because demand always exceeded the limited supply, the value of the authorities remained relatively high.

In 1980, the government relaxed entry restrictions and began issuing more operating authorities. As a result, the value of authorities previously issued fell substantially. Because they were often used as loan collateral and as a component of a firm's total assets, Congress passed this preferential provision to lessen the impact of their suddenly reduced value. In tax years 1980 and 1981 motor carrier firms were allowed to amortize the adjusted basis of operating authorities over a 60 month period.

This provision was authorized by Congress in Section 266 of the Economic Recovery Tax Act of 1981.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	None

1.40 FIVE-YEAR AMORTIZATION FOR HOUSING REHABILITATION

Internal Revenue Code, Section 167(k); Minnesota Statutes, Section 290.01, Subd. 20

Definition
A taxpayer may elect to amortize rather than depreciate certain expenditures incurred in the rehabilitation of low and moderate income rental housing. By electing to amortize these costs the taxpayer is allowed to deduct the expenditures over a shorter period. The taxpayer, however, forfeits any federal investment credit which otherwise would have been allowed. Qualifying expenditures must exceed a total of $3,000 per rental unit over two consecutive years, with a maximum of $20,000 per unit allowed ($40,000 per unit for certain government approved projects). Furthermore, only expenditures incurred prior to January 1, 1984, may be amortized.

Congress enacted this provision in 1969. It was last extended in 1981.

Fiscal Impact

FY 1984	$370,000*
FY 1985	340,000
FY 1986	340,000
FY 1987	340,000

1.41 FIVE-YEAR AMORTIZATION FOR REHABILITATION OF HISTORIC STRUCTURES (REPEALED)

Internal Revenue Code, Sections 167(n-o) and 191; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Beginning in 1977 and continuing through 1981, expenditures made by a taxpayer to preserve and restore

* Estimate includes 10% surcharge

certain historical structures were eligible for a special five-year rapid depreciation. This provision did not apply to owner-occupied housing. The amount of deduction allowed in excess of normal straight-line depreciation is the basis for this tax expenditure.

By allowing the rapid write-off the government essentially gives the taxpayer an interest-free loan. When the taxpayer takes larger than normal deductions in the early years he is "borrowing" tax money. When there are no depreciation deductions taken in the later years, the taxpayer is in essence paying back the "loan." The netting out of all taxpayers for any single year and the time value of the "loans" from the government's standpoint is what this tax expenditure measures. Because of the repeal date, the net fiscal impact of the five-year rapid write-off is now quite small and will result in no revenue loss by 1987.

This provision was passed by Congress and the Minnesota Legislature for tax year 1977 and following. It was repealed both on the federal and state levels beginning with tax year 1982.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	None

1.42 SEVEN-YEAR AMORTIZATION FOR REFORESTATION EXPENDITURES

Internal Revenue Code, Sections 48 and 194; Minnesota Statutes, Section 290.01, Subd. 20

Definition

Beginning with tax year 1980, individual and estate taxpayers may elect to amortize, over a seven-year period, reforestation expenditures incurred in connection with the commercial production of timber. Prior to 1980, taxpayers were required to treat reforestation costs as capital expenditures which were not recoverable until the timber was harvested. The amortization deduction is limited to a maximum of $10,000 per year over the seven-year period. Qualifying expenditures include the cost of seeds, seedlings, site preparation, labor, and machinery.

This provision was enacted by Congress in 1980. It was last changed in 1982.

Fiscal Impact

FY 1984	Minimal*
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

1.43 EXCESS OF PERCENTAGE OVER COST DEPLETION FOR OIL, GAS, AND NON-FUEL MINERALS

Internal Revenue Code, Sections 613 and 613A; Minnesota Statutes, Section 290.01, Subd. 20

Definition

Depletion allowances refer to the way in which investment costs are recovered for mining or other extractive operations. Depletion deductions are allowed on such diverse properties as oil and gas wells, mineral mines, peat bogs, clay mines, gravel quarries, and commercial stands of timber. In fact, depletion allowances may be taken for almost all exhaustible natural resources.

Taxpayers may choose from two forms of depletion: cost depletion and percentage depletion. Cost depletion is based on the taxpayer's basis in the property and is almost identical to depreciation in its application. Percentage depletion, on the other hand, is based on a percentage of the gross income received from the extrac-

* Estimate includes 10% surcharge

tive operation and has little relationship to a taxpayer's basis. Because cost depletion is a normal and necessary cost of doing business, only the amount of percentage depletion allowed over and above what cost depletion would allow is considered a tax expenditure.

Congress first allowed a deduction for cost depletion in 1913. Percentage depletion was first allowed as an option in 1926. Congress last changed this tax expenditure provision in 1978.

Fiscal Impact

FY 1984	$2,200,000*
FY 1985	2,100,000
FY 1986	2,000,000
FY 1987	2,000,000

1.44 EXPENSING OF CERTAIN CAPITAL OUTLAYS AND SPECIAL CASH ACCOUNTING RULES FOR FARMERS

Internal Revenue Code, Sections 162, 175, 180, 182, 278, 447, 464, 465, 704(d); Internal Revenue Service, Regulations 1.61-4, 1.162-12, and 1.471-6; Minnesota Statutes, Section 290.01, Subd. 20; Minnesota Rules, Part 8001.9000

Definition
The statutes and regulations cited above allow special tax treatment for agricultural based income. This is done in two ways: 1) by permitting the cost of capital outlays to be deducted in the year incurred, instead of throughout an asset's useful life; and 2) by mismatching income and expenses. Both treatments result in lower current-year tax liabilities for farmers.

Capital expenditures which are given special treatment include those made for soil and water conservation, fertilizer purchases, land clearing, and land improvement projects. Also, by permitting farming businesses to use the cash accounting system, rather than the accrual system, the government allows these taxpayers to deduct costs attributable to goods not yet sold, thereby deferring tax liability into successive years. The accrual system is normally required under the I.R.C. when the sale of products is a material factor of the business.

Farmers have been allowed to use the cash accounting system for tax purposes since the early 1920's. Congress began allowing the expensing of capital outlays in 1954.

Fiscal Impact

FY 1984	$13,000,000*
FY 1985	12,000,000
FY 1986	12,000,000
FY 1987	13,000,000

1.45 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174; Minnesota Statutes, Section 290.01, Subd. 20

Definition
A taxpayer may elect to expense in the current tax year, rather than capitalize, all qualified research and development costs incurred in connection with a trade or business. If the asset resulting from the research or development expenditures has no determinable useful life (such as is the case with a process or formula), then the taxpayer may alternatively elect to amortize the costs over not less than 60 months.

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. This provision is a tax expenditure because it allows immediate or accelerated deductions which defer present tax liability into future years.

* Estimate includes 10% surcharge

No substantial changes have been made to this provision since it was enacted by Congress in 1954 and adopted by the state in 1955.

Fiscal Impact

FY 1984	$720,000*
FY 1985	730,000
FY 1986	750,000
FY 1987	760,000

1.46 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 263 (c), 465, 616, 617, 704 (d), and 1254; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses. These costs are normally capital expenses, used to increase the taxpayer's basis in the property. The current year expensing of certain exploration and development costs acts to reduce current year ordinary income. Future capital gain income is somewhat increased because the costs are not capitalized, or added to basis, but the amount of that future increase is generally less than that of the current deduction. This preferential reduction and deferral of tax liability is a tax expenditure. Current year expensing is allowed for such items as labor costs, ground clearing, construction, and other site-preparation costs in the exploration and development of oil, gas, other fuel, and non-fuel mineral deposits.

Current year expensing of development costs for oil and gas has been allowed by Congress since 1916. Expensing of development costs for other minerals and of exploration costs for all minerals, including oil and gas, was first allowed in 1951.

Fiscal Impact

FY 1984	$ 3,100,000*
FY 1985	2,400,000
FY 1986	2,500,000
FY 1987	2,500,000

1.47 INDIVIDUAL RETIREMENT ACCOUNTS

Internal Revenue Code, Sections 219 and 408; Minnesota Statutes, Section 290.01, Subd. 20 and Subd. 20a(17-18)

Definition
Minnesota taxpayers who do not have qualified pension plans at their place of employment may take a deduction for contributions to an individual retirement account (IRA) up to a maximum of $1,500 ($1,750 for married couples with separate accounts) or 15% of wage income, whichever is less. The state's treatment of IRA's differs from the federal treatment. Federally, taxpayers may take a deduction for contributions up to a maximum of $2,000 ($2,250 for married couples) or an amount equal to total wage income, whichever is less. Also, federal treatment allows this deduction for employees who have pension plans where they work.

It should be noted that the estimated annual fiscal impact to the state for this tax expenditure does not necessarily equal the aggregate tax benefits received by individual taxpayers. When an individual contributes to an IRA using current year income, he gains primarily through the deferral of a tax on that contribution, but also because the distribution will occur in a year, usually after retirement, when his marginal tax rate will generally be lower. The state's revenue loss for any one tax year, on the other hand, is equal to:

1. the loss from the current year deduction of IRA contributions at the federal level, offset by the

* Estimate includes 10% surcharge

add-back of some of those deductions at the state level; plus

2. the loss from the exclusion of current year earnings on IRA funds (which would be taxable in the year earned for normal savings accounts); minus
3. the gain from the taxation of current year disbursements (of previously untaxed contributions and earnings).

Although a self-employed individual is eligible to open an IRA, he may also choose a Keogh plan, which is available only to self-employed persons. Keogh plans are treated separately in item 1.48.

Some part of retirement account distributions may be subject to Minnesota's partial exclusion for retirement income. The impact of that exclusion is included in the estimate of item 1.51 (Pension, Retirement, or Severance Income).

This provision was enacted in 1975. Prior to 1982 the state conformed to federal treatment. However, when the federal provision was expanded in 1982, the state did not update to the change but instead retained the pre-1982 federal language. The last change occurred in 1983.

Fiscal Impact

FY 1984	$49,000,000*
FY 1985	52,000,000
FY 1986	64,000,000
FY 1987	79,000,000

1.48 KEOGH PLANS

Internal Revenue Code, Sections 219, 220, 401-405, and 408-415; Minnesota Statutes, Section 290.01, Subd. 20 and Subd. 20a(17-18)

Definition
Self-employed taxpayers may take a deduction for contributions made to Keogh retirement plans of 15% of self-employment income up to a maximum deduction of $7,500. Similar to IRA's (item 1.47) the state's treatment of Keogh plans differs from the federal treatment. The federal government provides a deduction of 15% of self-employment income up to a maximum deduction of $15,000.

Again, as with the IRA's, fiscal impact estimates for the state are not necessarily a reflection of the aggregate benefits to individual taxpayers. An individual benefits from this provision by deferring tax liability on current income until retirement age, when his marginal tax rate will usually be lower. The revenue loss from the state's perspective is derived from the total deductions allowed in the current fiscal year, minus the plan distributions (retirement income) included in FAGI (see item 1.47).

Not all distributions from Keogh plans are taxed by the state. A discussion of the impact of the subtraction for pension income may be found in item 1.51 (Pension, Retirement, or Severance Income).

This provision was originally enacted in 1962. Prior to 1982 the state conformed to federal treatment of Keogh plans. However, in 1982 when the federal provision was expanded to its current language, the state chose to continue with the pre-1982 federal treatment.

Fiscal Impact

FY 1984	$ 750,000*
FY 1985	420,000
FY 1986	380,000
FY 1987	370,000

* Estimate includes 10% surcharge

1.49 FOREIGN HOUSING COSTS PAID BY TAXPAYER

Internal Revenue Code, Section 911; Minnesota Statutes, Section 290.01, Subd. 20

Definition
A taxpayer may reduce his federal gross income by an amount equal to that portion of his annual out-of-pocket foreign housing costs which, for tax year 1983, was equal to the excess of the taxpayer's qualified housing costs over $6,604 (an amount based on 16% of the salary of a federal employee at step 1 of grade GS-14). Employer-provided housing costs also are excluded from federal gross income (see item 1.12). However, the combined amount of the deduction and the exclusion (this item and 1.12) may not exceed the taxpayer's total foreign-earned income for the tax year.

The deduction for foreign housing costs was enacted by Congress in 1979. This provision as it currently exists became effective with tax year 1982.

Fiscal Impact

FY 1984	$240,000*
FY 1985	180,000
FY 1986	190,000
FY 1987	190,000

1.50 EMPLOYMENT-RELATED MOVING EXPENSES

Internal Revenue Code, Sections 62(8) and 217; Minnesota Statutes, Section 290.01, Subd. 20

Definition
Taxpayers may deduct from federal gross income certain reasonable moving expenses incurred in connection with starting work at a new principal place of employment. Although there is no overall dollar limitation to this deduction, certain expenses, such as those incurred in the sale, purchase or lease of a residence, do have specific dollar limitations. Further restrictions are that any amount received by an employee as reimbursement for moving expenses is taxable and must be included in FAGI, and the new job must be at least 35 miles further from the old residence than the old job was.

This provision was enacted in 1964 and was last revised in 1984. Prior to tax year 1984, only federal deductions claimed for moves to points within Minnesota were allowed in computing Minnesota gross income.

Fiscal Impact

FY 1984	$ 8,000,000*
FY 1985	11,000,000
FY 1986	12,000,000
FY 1987	13,000,000

* Estimate includes 10% surcharge

MINNESOTA ADJUSTMENTS

1.51 PENSION, RETIREMENT OR SEVERANCE INCOME (OTHER THAN SOCIAL SECURITY OR RAILROAD RETIREMENT BENEFITS)

Minnesota Statutes, Sections 290.01, Subd. 20b (6) and 290.08, Subd. 26

Definition
Minnesota taxpayers may exclude pension, retirement or severance income up to a maximum of $11,000 per year. This maximum is reduced dollar-for-dollar by all FAGI in excess of $17,000. This tax expenditure does not include the exemption of social security benefits (see item 1.53, below). Beginning in 1985 the state will offer taxpayers a choice between the above exclusion, and an exclusion of $11,000 reduced by FAGI over $23,000, but further reduced by social security or railroad retirement benefits.

This exclusion does apply to disability income. Prior to tax year 1984, disability income was excluded under a separate federal provision (see item 1.16). In 1984 Congress began to tax disability income. At that time Minnesota administratively began treating that income as pension income. Accordingly, estimates below for fiscal years 1985-1987 include the impact of an exclusion for disability income while the fiscal year 1984 estimate does not.

Minnesota began excluding all government pension income in 1933. Beginning with tax year 1978 the total exclusion of public employee pensions was changed to be an exclusion of any pensions, public or private, but the exclusion was limited to a maximum amount with qualifying offsets or reductions. This provision was last amended in 1984.

Fiscal Impact

FY 1984	$ 87,000,000*
FY 1985	94,000,000
FY 1986	114,000,000
FY 1987	132,000,000

1.52 UNEMPLOYMENT COMPENSATION

Internal Revenue Code, Section 85; Minnesota Statutes, Section 290.01, Subd. 20 and 20b (12)

Definition
Minnesota does not tax any unemployment compensation benefits and thus allows any federally taxed benefits to be subtracted from federal adjusted gross income.

The fiscal impact totals shown below measure the total tax relief provided because Minnesota does not tax any of this income. The federal portion of the estimate measures what is not taxed by the federal government, and the Minnesota portion measures the additional tax relief provided because Minnesota does not tax the portion that is taxed by the federal government.

The federal government began excluding unemployment compensation benefits in 1938. In 1979 it began taxing a portion of unemployment compensation. Beginning with the 1983 tax year the unemployment compensation included in federal adjusted gross income is equal to one-half of the amount of unemployment compensation combined with other income over $12,000 for a single filer and $18,000 for married-joint filers, up to the taxpayer's full amount of unemployment compensation. The Minnesota subtraction for unemployment compensation has been equal to the amount included in federal adjusted gross income for each year since 1979.

* Estimate includes 10% surcharge

Fiscal Impact

	Federal Portion	Minnesota Portion	Total
FY 1984	$49,000,000*	$18,000,000*	$67,000,000*
FY 1985	26,000,000	13,000,000	39,000,000
FY 1986	32,000,000	12,000,000	44,000,000
FY 1987	39,000,000	11,000,000	50,000,000

1.53 SOCIAL SECURITY BENEFITS

Internal Revenue Code, Section 86; Minnesota Statutes, Section 290.01, Subd. 20 and 20b (18)

Definition
Minnesota does not tax any social security benefits and thus allows any federally taxed benefits to be subtracted from federal adjusted gross income.

The fiscal impact totals shown below measure the total tax relief provided because Minnesota does not tax any of this income. The federal portion of the estimate measures what is not taxed by the federal government, and the Minnesota portion measures the additional tax relief provided because Minnesota does not tax the portion that is taxed by the federal government.

Beginning with the 1984 tax year, a portion of social security benefits is taxed by the federal government for taxpayers whose federal adjusted gross income exceeds $25,000 for a single filer and $32,000 for married-joint filers. If the taxpayer's income is above these thresholds, the amount of social security benefits included in income to be taxed is the lesser of 1) one-half of the benefits received or 2) one-half of the excess over the income thresholds of the sum of the taxpayer's federal adjusted gross income plus interest on tax-exempt obligations plus one-half of the social security benefits. The Minnesota subtraction for social security is equal to the amount included in federal adjusted gross income.

Prior to 1984 social security benefits had never been specifically excluded from taxation by federal or state statute. However, administrative decisions, court rulings, and revenue rulings had established their tax-free status. The Social Security Act amendments of 1983 established the federal taxation of a portion of social security benefits, beginning in 1984. In 1984 Minnesota enacted the subtraction.

Fiscal Impact

	Federal Portion	Minnesota Portion	Total
FY 1984	$300,000,000*	None	$300,000,000*
FY 1985	270,000,000	$19,000,000	289,000,000
FY 1986	290,000,000	23,000,000	313,000,000
FY 1987	310,000,000	28,000,000	338,000,000

1.54 FEDERAL INCOME TAXES

Minnesota Statutes, Section 290.18, Subd. 2

Definition
Minnesota taxpayers are allowed to deduct their federal income tax liability from Minnesota gross income in computing taxable income. The deduction is limited to federal taxes paid on that portion of FAGI which is taxed in Minnesota. For instance, if a taxpayer has certain Minnesota subtractions (the pension exclusion, military pay exclusion, social security or railroad retirement exclusion, U.S. bond interest, and unemployment compensation) which are in excess of the married couple adjustment amount (a Minnesota addition),

* Estimate includes 10% surcharge

the taxpayer must reduce this deduction by the ratio of that excess to FAGI.

Minnesota has allowed a deduction for federal income taxes since 1933. The provision was last changed in 1984.

Fiscal Impact

FY 1984	$590,000,000*
FY 1985	620,000,000
FY 1986	680,000,000
FY 1987	740,000,000

1.55 MILITARY PAY

Minnesota Statutes, Section 290.01, Subd. 20b(10)

Definition
A Minnesota resident who is serving in the Armed Forces of the United States or of the United Nations may subtract from FAGI the first $3,000 of military compensation received. The taxpayer may subtract an additional $2,000 of military compensation if the military service is performed wholly outside of Minnesota. Nonresident taxpayers may subtract the full amount of their military pay regardless of where they are stationed.

This provision was first enacted by the Legislature in 1943 for tax year 1942 and was in effect through 1977. For tax year 1978 an income tax credit of $140 was provided for members of the National Guard only. For tax year 1979 the credit was repealed and the subtraction for members of the Armed Forces was reinstated.

Fiscal Impact

FY 1984	$14,000,000*
FY 1985	13,000,000
FY 1986	14,000,000
FY 1987	16,000,000

1.56 EXPENSE MONEY PAID TO LEGISLATORS

Internal Revenue Code, Section 162(h); Minnesota Statutes, Sections 290.01, Subd. 20 and 290.09, Subd. 2(c)

Definition
Minnesota does not tax any per diem allowances received by Minnesota legislators and thus allows any federally taxed benefits to be subtracted from federal adjusted gross income.

The federal provision allows the exclusion only for legislators who reside more than 50 miles from the state capitol building and only for per diem allowances received for days that the Legislature is in session and for committee meetings that the legislator is required to attend. The additional amounts subtracted for the Minnesota income tax therefore include all per diem amounts for legislators who reside within 50 miles of the capitol building and interim per diem paid for days on official business for legislators who reside more than 50 miles from the capitol. For fiscal year 1984 the session per diem was $36 and the interim per diem was $48.

Minnesota first enacted this provision in 1959. The federal deduction became effective in 1976 and the 50-mile restriction became effective in 1980. The provision was last changed in 1981.

* Estimate includes 10% surcharge

Fiscal Impact

FY 1984	$140,000*
FY 1985	Minimal
FY 1986	150,000
FY 1987	Minimal

1.57 INTEREST ON FAMILY FARM SECURITY LOANS

Minnesota Statutes, Section 290.01, Subd. 20b(9)

Definition
When agricultural land is sold by means of a seller-sponsored loan, and repayment is guaranteed by the state through the family farm security loan program, the interest earned by the seller may be subtracted from FAGI for Minnesota tax purposes.

In order for a seller-sponsored loan to qualify for the family farm security loan program, the borrower must meet certain eligibility requirements and the term of the loan may not exceed 20 years. For a related discussion, see item 1.58, below.

The Minnesota family farm security loan program was enacted in 1976. However, it was not until 1978 that this subtraction for interest was enacted, and then only for seller-sponsored loans executed after December 31, 1977, and before January 1, 1982. In 1981, the subtraction was extended to include all qualified loans executed before January 1, 1986.

Fiscal Impact

FY 1984	$630,000*
FY 1985	630,000
FY 1986	730,000
FY 1987	720,000

1.58 INTEREST ON CONTRACT-FOR-DEED SALES OF AGRICULTURAL LAND

Minnesota Statutes, Section 290.01, Subd. 20b(14)

Definition
Under certain circumstances, interest received from contract-for-deed sales of agricultural land may be subtracted from FAGI for state tax purposes. In order for interest income to qualify for this tax-free status, the interest rate for the contract-for-deed must be no higher than nine percent. Further requirements are that the purchaser of the property: 1) have a total net worth of $150,000 or less; 2) intend to use the property for agricultural purposes; and 3) be purchasing 1,000 acres or less of land. This provision, which is very similar to item 1.57, above, applies only to those contracts-for-deed entered into after December 31, 1981, and before July 1, 1983.

This provision was enacted by the Legislature in 1981 and was last changed in 1982.

Fiscal Impact

FY 1984	$220,000*
FY 1985	220,000
FY 1986	210,000
FY 1987	210,000

* Estimate includes 10% surcharge

MINNESOTA DEDUCTIONS

1.59 ITEMIZED DEDUCTION ALLOCATION

Minnesota Statutes, Section 290.39, Subd. 2

Definition
There are three methods married persons can use to file their returns. They can choose to file a combined return, a joint return, or separate returns. When they file a combined return they must list their FAGI according to whoever earned the income, but they may allocate their itemized deductions in any manner they choose. Allowing this allocation is a tax expenditure insofar as it mismatches income and deductions for a taxpayer, and causes the spouse with the higher income to pay a lower marginal rate than they would without this option. The estimates below measure the difference between current treatment and what would be the case if itemized deductions were required to be allocated to each spouse according to the portion of income each earned.

Married filers were first allowed to file separately on a combined return in 1971. This provision has not been changed since then.

Fiscal Impact

FY 1984	$15,000,000*
FY 1985	16,000,000
FY 1986	17,000,000
FY 1987	18,000,000

1.60 STANDARD DEDUCTION

Minnesota Statutes, Section 290.089, Subd. 3

Definition
All Minnesota taxpayers may take a personal deduction from Minnesota adjusted gross income (MAGI) when computing their taxable income. They may choose to either itemize their deductions (see items 1.61 through 1.72), or claim the standard deduction, whichever is greater. The standard deduction is equal to ten percent of MAGI, up to an indexed ceiling of $2,300 for tax year 1984. Married couples filing a combined return must both use the same type of personal deduction. The estimates below show the amount of revenue forgone due to the standard deduction alone. They do not attempt to measure the impact from a repeal of the standard deduction combined with the growth in itemized deductions that would result from a repeal.

The standard deduction provision is included in this report, not because it is a preferential provision (equally situated taxpayers do receive equal treatment), but rather for informational purposes and because it may in some degree be viewed as a convenient proxy for a certain minimum level of itemized deductions.

The standard deduction was first allowed in 1949, when it was ten percent of MAGI up to a $500 maximum. The ceiling amount was set at $2,000 in 1979 and was first indexed in 1981. The provision was last changed in 1984.

Fiscal Impact

FY 1984	$ 99,000,000*
FY 1985	105,000,000
FY 1986	114,000,000
FY 1987	125,000,000

* Estimate includes 10% surcharge

1.61 MEDICAL AND DENTAL EXPENSES

Internal Revenue Code, Sections 63(f) and 213; Minnesota Statutes, Section 290.089, Subd. 2

Definition
Taxpayers are allowed a deduction for expenses incurred for medical treatment, health care, health insurance, and transportation which is primarily for and essential to medical care. The deduction is equal to the portion of the sum of all qualified medical expenses exceeding five percent of FAGI.

A deduction for medical expenses has been allowed by Minnesota since 1933. The state adopted the federal provisions for this deduction beginning with tax year 1982. The last change took effect in tax year 1984.

Fiscal Impact

FY 1984	$59,000,000*
FY 1985	60,000,000
FY 1986	63,000,000
FY 1987	67,000,000

1.62 REAL ESTATE TAXES (REDUCED BY PROPERTY TAX REFUND)

Internal Revenue Code, Sections 63(f) and 164; Minnesota Statutes, Sections 290.089, Subd. 2, and 290A.16

Definition
Real estate taxes paid during the taxable year (less the Minnesota property tax refund received) may be deducted from Minnesota gross income in arriving at Minnesota taxable income. Special assessments are not considered real estate taxes and as such cannot be deducted. Business or trade-related real estate taxes are not considered tax expenditures because these are necessary costs of earning income and are not included in the estimates below.

Minnesota has allowed this itemized deduction since 1933. Upon enactment of the property tax refund, this deduction was reduced by the amount of that refund to determine the net property tax paid, beginning in 1976.

Fiscal Impact

FY 1984	$79,000,000*
FY 1985	78,000,000
FY 1986	84,000,000
FY 1987	91,000,000

1.63 GENERAL SALES TAX

Internal Revenue Code, Sections 63(f) and 164; Minnesota Statutes, Section 290.089, Subd. 2

Definition
All sales taxes paid within the taxable year may be deducted from Minnesota gross income in arriving at Minnesota taxable income. The amount deductible is determined from either the taxpayer's records of the actual sales tax paid during the year or from the Optional State Sales Tax Tables included in the federal tax form 1040 booklet. The estimates below do not include the excise tax paid on the purchase of motor vehicles, as this is found in item 1.64.

This provision allowing for sales taxes to be deducted was enacted in 1933 and last changed in 1983. The general Minnesota sales tax was enacted in 1967.

* Estimate includes 10% surcharge

Fiscal Impact

FY 1984	$37,000,000*
FY 1985	38,000,000
FY 1986	42,000,000
FY 1987	46,000,000

1.64 MOTOR VEHICLE EXCISE TAX

Internal Revenue Code, Sections 63(f) and 164; Minnesota Statutes, Section 290.089, Subd. 2

Definition
Minnesota taxpayers are allowed an itemized deduction equal to the amount of excise tax paid on the purchase of motor vehicles. The Minnesota motor vehicle tax rate is currently six percent of the purchase price and is applied to the sale or transfer of any motor vehicle required to be registered in Minnesota.

A deduction for several taxes, including those paid on motor vehicles, has been allowed in Minnesota since 1933. The Minnesota sales tax, enacted in 1967 at a three percent rate, included motor vehicles in the tax base until 1971, at which time the state motor vehicle excise tax was separately established at a three percent rate.

Fiscal Impact

FY 1984	$12,000,000*
FY 1985	14,000,000
FY 1986	16,000,000
FY 1987	17,000,000

1.65 MOTOR VEHICLE REGISTRATION TAX

Internal Revenue Code, Sections 63(f) and 164; Minnesota Statutes, Section 290.089, Subd. 2

Definition
Under federal provisions adopted by state law, Minnesota taxpayers may take an itemized deduction for the ad valorem portion of motor vehicle registration taxes paid during the tax year. A general discussion of the Minnesota motor vehicle registration tax may be found in the introduction to that chapter of this study.

This deduction was enacted in 1933. It was last changed in 1983.

Fiscal Impact

FY 1984	$7,600,000*
FY 1985	7,500,000
FY 1986	8,400,000
FY 1987	9,400,000

1.66 INTEREST ON HOME MORTGAGES

Internal Revenue Code, Sections 63(f) and 163; Minnesota Statutes, Section 290.089, Subd. 2

Definition
When computing Minnesota taxable income a taxpayer may take an itemized deduction for the full amount of all mortgage interest paid on his owner-occupied home. This includes interest paid on contracts for deed as well as that paid on traditional mortgages. Slightly more than thirty percent of all Minnesota individual income tax returns claim this deduction.

* Estimate includes 10% surcharge

Home mortgage interest has been deductible from Minnesota gross income since 1933.

Fiscal Impact

FY 1984	$250,000,000*
FY 1985	270,000,000
FY 1986	320,000,000
FY 1987	390,000,000

1.67 NONMORTAGE INTEREST

Internal Revenue Code, Sections 63(f) and 163; Minnesota Statutes, Section 290.089, Subd. 2

Definition
Minnesota allows individual taxpayers an itemized deduction for all interest paid. In general, a taxpayer may take this deduction for all interest paid on non-business indebtedness during the tax year. Other deductions are allowed for business-related interest, but because they represent a necessary cost of earning income they are not included in this study. Nonmortgage interest includes interest paid on personal debt, credit cards, bank loans, and installment purchases of real or personal property. Prepaid interest must be deducted over the full life of the loan.

Certain types of nonbusiness interest do not qualify for this deduction. These include: (1) interest on a debt incurred in the purchase of certain life insurance policies; (2) interest on a debt incurred in the earning of tax-exempt income, such as loans taken to buy government bonds; and (3) interest on debt for which the taxpayer is not legally liable.

Interest deductions were included in the earliest federal income tax laws. They were also present in the 1933 Minnesota income tax laws.

Fiscal Impact

FY 1984	$100,000,000*
FY 1985	100,000,000
FY 1986	110,000,000
FY 1987	110,000,000

1.68 CHARITABLE CONTRIBUTIONS

Internal Revenue Code, Sections 63(f) and 170; Minnesota Statutes, Section 290.089, Subd. 2(h)

Definition
Minnesota allows a deduction for contributions to fraternal or community organizations made within the tax year of up to 20% of Minnesota gross income (MGI). All other contributions may be deducted up to a total of 30% of MGI. Deductions must be taken in the year contributions are made.

This deduction is one of the few allowed by the state where Minnesota's treatment does not conform to federal treatment. Federal law generally allows taxpayers to take a deduction for charitable contributions up to 50% of FAGI, and also allows any excess charitable contributions to be carried forward for up to five years.

Although Minnesota has allowed this deduction since the inception of the income tax, it has never been the same as the federal deduction. In 1983, when the Legislature generally conformed to the federal definition of itemized deductions, the federal deduction for charitable contributions was not adopted.

* Estimate includes 10% surcharge

Fiscal Impact

FY 1984	$100,000,000*
FY 1985	100,000,000
FY 1986	120,000,000
FY 1987	130,000,000

1.69 NONBUSINESS CASUALTY AND THEFT LOSSES

Internal Revenue Code, Sections 63(f) and 165; Minnesota Statutes, Section 290.089, Subd. 2

Definition
A taxpayer may deduct any loss from casualty or theft provided the loss exceeds ten percent of the taxpayer's federal adjusted gross income (FAGI), or ten percent of combined FAGI for married couples filing jointly. The loss value of the property is equal to either the cost basis of the property or the difference between the fair market values of the property prior to the incident and immediately following the incident. The loss value over $100 is reduced by any insurance or reimbursements received and ten percent of the taxpayer's FAGI to arrive at the deductible loss value. This provision and the following estimate applies only to losses involving non-business property.

A deduction for casualty or theft loss was first authorized for the federal income tax in 1913 and for the state tax in 1933. This deduction is now the same as the federal deduction and was last changed in 1983.

Fiscal Impact

FY 1984	$1,600,000*
FY 1985	1,500,000
FY 1986	1,600,000
FY 1987	1,700,000

1.70 TAX RETURN PREPARATION FEES

Internal Revenue Code, Sections 63(f) and 212(3); Minnesota Statutes, Section 290.089, Subd. 2

Definition
Minnesota taxpayers may deduct fees paid for qualified tax counsel and assistance "in connection with the determination, collections, or refund of any tax." (I.R.C., Section 212(3).)

Since 1933, Minnesota has allowed a deduction for expenses "ordinary and necessary" in the production of income. In 1959, language specifically allowing the deduction for tax return preparation fees was first enacted by the Legislature. In 1983, Minnesota adopted the federal definition of most itemized deductions, including this one. However, no substantive change in this deduction resulted from that legislation.

Fiscal Impact

FY 1984	$5,800,000*
FY 1985	5,900,000
FY 1986	6,400,000
FY 1987	6,800,000

1.71 ADOPTION EXPENSES

Internal Revenue Code, Sections 63(f) and 222; Minnesota Statutes, Section 290.089, Subd. 2 and 4

Definition
Adoption expenses are deductible from Minnesota adjusted gross income up to a maximum of $1,250

* Estimate includes 10% surcharge

($1,500 for adoption of children with "special needs"). Adoption costs, which include attorney fees, court costs, and agency fees, must be deducted in the year paid.

This provision is one of the few remaining deductions for which the state has not conformed to federal law. Federally, a deduction is allowed only for adoption of children with special needs (those who are difficult to place for some reason).

This deduction was enacted by the Legislature in 1969. The original maximum amount of $450 was increased to $1,250 in 1973.

Fiscal Impact

FY 1984	$190,000*
FY 1985	180,000
FY 1986	190,000
FY 1987	200,000

1.72 DEDUCTION FOR TUITION, TRANSPORTATION, AND NONRELIGIOUS TEXTBOOKS FOR DEPENDENTS

Minnesota Statutes, Section 290.089, Subd. 2(a)

Definition
Minnesota taxpayers may deduct certain dependent education expenses from Minnesota income. Qualifying public or private school expenses include those for tuition, transportation, and nonreligious textbooks or supplies required for a subject commonly taught in the public schools. Prior to tax year 1985 taxpayers were allowed deductions up to $500 per child in kindergarten through sixth grade and up to $700 per child in seventh through twelfth grades. Effective for tax year 1985 and following these maximum deductions were increased to $650 and $1,000, respectively.

This deduction has been allowed since 1955. From 1971 through 1973 Minnesota also provided a credit for tuition paid to private schools, but that was declared unconstitutional and repealed. In 1983 the U.S. Supreme Court ruled that the deduction was constitutional. This provision was last changed in 1984.

Fiscal Impact

FY 1984	$6,100,000*
FY 1985	5,800,000
FY 1986	7,300,000
FY 1987	7,700,000

* Estimate includes 10% surcharge

MINNESOTA CREDITS

1.73 PERSONAL CREDITS FOR AGE 65 AND OVER, BLIND, DEAF, AND QUADRIPLEGIC

Minnesota Statutes, Section 290.06, Subd. 3f and 3g

Definition
If a taxpayer and/or spouse is age 65 or over, blind, deaf, or quadriplegic, a nonrefundable personal credit may be claimed for each category that applies. Credits may also be claimed for dependents who are blind, deaf, or quadriplegic. The amount of these credits is subject to indexing on an annual basis to adjust for inflation. The credit amount for tax year 1984 was $70.

Nonresidents may take only a proportion of the credits equal to their Minnesota gross income divided by their total gross income.

The above credits were enacted in the following years: senior citizen and blind, 1951; deaf, 1975; quadriplegic, 1979. These credits were first indexed in tax year 1981.

Fiscal Impact

	Age 65	Blind	Deaf	Quadriplegic	Total
FY 1984	$20,000,000	$390,000	$270,000	$66,000	$20,726,000
FY 1985	21,000,000	430,000	280,000	67,000	21,777,000
FY 1986	23,000,000	470,000	300,000	73,000	23,843,000
FY 1987	25,000,000	530,000	320,000	79,000	25,929,000

1.74 PERSONAL CREDITS FOR DEPENDENTS

Minnesota Statutes, Section 290.06, Subd. 3f and 3g

Definition
A taxpayer may claim a nonrefundable credit for each person who is dependent upon and receiving chief support from the taxpayer. Only one taxpayer may claim this credit with respect to any one dependent for any given tax year. This indexed credit was $70 for the 1984 tax year. Additional credits may also be claimed for dependents who are blind, deaf, or quadriplegic. The impact of these additional credits may be seen in item 1.73.

Personal credits are also allowed for the taxpayer and spouse at the same dollar amount as the credit for dependents. However, because each taxpayer, or taxpayer and spouse, is given equal tax relief, these personal credits are not considered tax expenditures and are not included in the estimates.

From 1933 to 1936 Minnesota allowed a $250 exemption for each dependent. A special session of the Legislature in 1937 replaced this exemption with a $5 credit per dependent. The Legislature increased the amount of the dependent credit several times over the years to $60 for the 1980 tax year. Beginning with the 1981 tax year the credit has been indexed for inflation.

Fiscal Impact

FY 1984	$79,000,000
FY 1985	83,000,000
FY 1986	86,000,000
FY 1987	90,000,000

1.75 HOMEMAKER CREDIT

Minnesota Statutes, Section 290.06, Subd. 3e

Definition
A taxpayer is allowed a credit of $50 against the Minnesota tax, provided that either the taxpayer or the taxpayer's spouse is not employed for the entire tax year and devotes his or her time to the care of children in the home. In order to claim this nonrefundable credit a taxpayer must have a child 15 years or younger residing at home, and the combined federal adjusted gross income of the taxpayer and spouse must be less than $25,000. The credit is limited to $50 regardless of the level of qualifying income or the number of children residing at home. This credit applies to individual taxpayers only, and not to estates or trusts.

The homemaker credit was enacted by the Minnesota Legislature in 1978 and was last changed in 1984.

Fiscal Impact

FY 1984	$2,300,000
FY 1985	2,300,000
FY 1986	2,200,000
FY 1987	2,000,000

1.76 CREDIT FOR INCOME TAX PAID TO OTHER STATES AND RECIPROCITY

Minnesota Statutes, Section 290.081

Definition
A resident taxpayer is eligible for a nonrefundable credit for income taxes paid to another state or Canadian province to the extent that income taxed in the other state or province is included in Minnesota gross income. The credit is the lesser of the tax owed to the other state or province, or the amount computed by multiplying the Minnesota gross tax computed on all income, less personal credits, times the percentage that the income earned outside Minnesota is to Minnesota gross income.

All other states which impose an income tax have similar credits for income taxes paid to other states, suggesting that it is far from certain Minnesota could fully repeal this provision. A repeal which caused some income to be taxed twice could violate the federal Constitution. An example of how the credit could be eliminated without taxing income twice occurs in the case of wage and personal service income earned in a state with which Minnesota has a reciprocity agreement. Minnesota entered into such reciprocity agreements with Wisconsin in 1968, with North Dakota in 1969, and with Michigan in 1984. Under these agreements a taxpayer with wage and personal service income is required to file an income tax return only in the state of his residency.

Since 1973 the Minnesota-Wisconsin reciprocity agreement has included a unique reimbursement provision. The state which experiences a net revenue loss due to reciprocity is reimbursed by the other state for the amount of that loss, and therefore this reciprocity agreement is not considered a tax expenditure. The reciprocity agreements with North Dakota and Michigan have no provisions for reimbursement, however they are not considered tax expenditures either since there is no estimated revenue loss for Minnesota. Between these states and Minnesota there is estimated to be essentially a state-to-state balance of taxpayers affected by reciprocity.

This credit dates back to 1940. Prior to 1978 it was allowed only for taxes paid to other states on income from wages and personal services. In 1978 the credit was broadened to include all income taxes paid to other states. The last revision to this provision occurred in 1983.

Fiscal Impact

FY 1984	$4,600,000
FY 1985	5,300,000
FY 1986	6,000,000
FY 1987	7,000,000

1.77 POLITICAL CONTRIBUTION CREDIT

Minnesota Statutes, Section 290.06, Subd. 11

Definition
A taxpayer may take a nonrefundable credit against his Minnesota income tax for contributions made to certain candidates for elective state and federal public offices and to certain political parties. The amount of the credit is equal to fifty percent of the qualifying contributions made during the tax year, with a maximum credit of $50 for individuals and $100 for married couples filing joint or combined returns. Contributions to state candidates qualify only if the candidate has signed an agreement with the Minnesota Board of Ethical Practices agreeing to limit campaign spending.

This credit first went into effect with the 1974 tax year. The maximum credit was raised to its current level in 1979. The last change made to this provision occurred in 1984.

Fiscal Impact

FY 1984	$4,300,000
FY 1985	6,100,000
FY 1986	5,900,000
FY 1987	7,400,000

1.78 RESIDENTIAL ENERGY CREDIT (REPEALED)

Minnesota Statutes, Section 290.06, Subd. 14

Definition
Minnesota taxpayers may claim a nonrefundable credit for costs incurred in installing certain renewable energy sources in a principal residence. The credit amount is equal to 20% of the first $10,000 of qualified renewable energy resource expenditures. Qualified expenditures include those for solar collectors, passive solar systems, earth sheltered homes, and biomass conversion equipment..Although the credit is not refundable, unused credit amounts can be carried forward to successive years up through 1987. However, in no case can the total credit for all years exceed $2,000.

This credit is similar to the federal credit of the same name, but there are significant differences. Chief among these is that the federal credit may be taken for costs associated with insulation and other energy conservation measures, as well as for renewable energy source costs, while the Minnesota credit is limited to the cost of renewable energy sources.

The credit was enacted by the Legislature in 1979. The provision was last amended in 1983 and is set to expire on December 31, 1985.

Fiscal Impact

FY 1984	$2,800,000
FY 1985	3,800,000
FY 1986	5,800,000
FY 1987	500,000

1.79 LOW INCOME CREDIT

Minnesota Statutes, Section 290.06, Subd. 3d

Definition
Minnesotans may take a credit equal to their tax liability after nonrefundable credits provided that their household income is equal to or less than the following limits:

Family Size	Maximum Household Income
1	$ 5,800
2	7,400
3	8,800
4	10,000
5	10,500
6 or more	11,000

For taxpayers whose household income exceeds these amounts, an alternative tax is calculated as 15% of the excess over the limits. The credit is then the difference between the tax under that calculation and the tax that would have resulted from the "normal" calculations. No one who is a dependent of another, and no one whose household income is greater than $20,000, may claim this credit.

The low income credit was enacted in 1974. The original income levels were raised frequently through the 1970's and were set at current levels in 1980.

Fiscal Impact

FY 1984	$8,500,000
FY 1985	8,100,000
FY 1986	7,800,000
FY 1987	7,400,000

1.80 POLLUTION CONTROL CREDITS

Minnesota Statutes, Section 290.06, Subd. 17 and 18

Definition

For tax years beginning after December 31, 1984, taxpayers may take a nonrefundable credit for the purchase of pollution control devices intended to "prevent, control, or abate pollution," or reduce the generation of hazardous waste, within Minnesota. Two categories of pollution control equipment qualify for separate credits.

The first credit is given for equipment purchased which is generally used to "abate or control pollutants to meet or exceed state laws, rules, or standards," or used for the reduction of hazardous waste generation. The credit amount is equal to five percent of the cost of the equipment. Although the maximum credit amount for any one tax year may not exceed total tax liability or $75,000, whichever is less, any unused credit may be carried forward for up to four succeeding years.

The second type of pollution control credit is for the purchase of feedlot pollution control equipment. These devices are used for the prevention of air, water, or land pollution resulting from the operation of livestock, poultry, or animal lots. Qualified expenses include those incurred in the purchase of lagoons, concrete storage pits or slurry handling equipment. The credit amount is equal to ten percent of the cost of the equipment. As above, any credit amount which exceeds the current tax liability of the taxpayer may be carried forward for up to four succeeding years. However, unlike the credit above, there is no absolute maximum dollar limit to this credit; however, the credit may not exceed the current tax liability.

The first pollution control credit was enacted by the Minnesota Legislature in 1969 and was repealed in 1983. The feedlot pollution control credit was enacted in 1971 and repealed in 1983. In 1984 the Legislature re-enacted the feedlot pollution control credit and the regular pollution control credit, expanding the latter to include hazardous waste abatement equipment for the first time.

Fiscal Impact

FY 1984	$ 300,000
FY 1985	Minimal
FY 1986	2,000,000
FY 1987	2,000,000

1.81 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

Definition
A taxpayer may claim a nonrefundable credit against tax due for qualified research and development expenses incurred in a Minnesota trade or business. Expenses must exceed the average yearly research and development expenditures for three preceding years to qualify. This three-year average is referred to as "base year" expenditures. Expenditures include such things as wages paid to researchers, costs of supplies used in conducting research, rental costs of personal property used in research, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

The credit is equal to 12.5% of the first $2,000,000 of the increase in current year expenditures over base year expenditures. A credit equal to 6.25% is allowed for amounts in excess of $2,000,000. The credit claimed may not exceed 50% of a taxpayer's current research and development expenditures, nor can it exceed the taxpayer's current tax liability. However, the credit may be carried forward for up to 15 years and back for up to three years.

The research and development credit was enacted in 1981, effective beginning with tax year 1982. It was last changed by the Legislature in 1983.

Fiscal Impact

FY 1984	$310,000
FY 1985	360,000
FY 1986	400,000
FY 1987	400,000

1.82 CREDIT FOR EQUITY INVESTMENT IN A SMALL BUSINESS (REPEALED)

Minnesota Statutes, Section 290.069, Subd. 4

Definition
Taxpayers may claim a credit equal to 30% of the net investment in excess of $25,000 in the equity stock of a "qualified" small business. The credit may not exceed $75,000, or 75% of the taxpayer's tax liability after the subtraction of all other credits, whichever is less. Additionally, the credit may not be taken if the taxpayer owns more than 49% of the small business's stock, or if the stock pays either fixed or variable interest rates. If the small business is located within an enterprise zone, credit may be taken for investments in excess of $10,000, up to a maximum credit amount of $100,000. Excess credit amounts may be carried forward for up to five years. No carryback is allowed.

This credit was enacted in 1983, effective for tax years 1984 and 1985. The provision expires for tax years beginning after December 31, 1985.

Fiscal Impact

FY 1984	None
FY 1985	$110,000
FY 1986	110,000
FY 1987	Minimal

1.83 RESOURCE RECOVERY EQUIPMENT CREDIT

Minnesota Statutes, Section 290.06, Subd. 16

Definition
Beginning in tax year 1984, Minnesota taxpayers may claim a nonrefundable credit of ten percent of the costs incurred in purchasing qualifying equipment used for processing solid or hazardous waste at a resource recovery facility. Unlike the credits presented in item 1.80, this credit is not for the "prevention, control, or abatement" of pollution, but rather for equipment installed in a resource recovery facility. There are currently no hazardous waste recovery facilities located in the state, and no indication such a facility will be built over the time span of this study. Therefore, the estimates below apply only to solid waste processing equipment. Qualifying equipment includes those used for incineration, recycling, and composting. Although the credit is nonrefundable, any excess credit amount may be carried forward for up to four succeeding years.

This provision was enacted by the Minnesota Legislature in 1984.

Fiscal Impact

FY 1984	None
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

1.84 CONSERVATION TILLAGE EQUIPMENT CREDIT

Minnesota Statutes, Section 290.06, Subd. 19

Definition
Effective with taxable years beginning after December 31, 1984, taxpayers may claim a nonrefundable credit equal to ten percent of the net cost of qualified conservation tillage equipment. Qualified equipment includes conservation tillage planters and planting attachments designed to plant row or small grain crops under the no-till, ridge-till, or strip-till methods of conservation tillage. The credit may not exceed tax liability, but it may be carried back for up to three years and forward for up to five years.

This credit was enacted in 1984.

Fiscal Impact

FY 1984	None
FY 1985	$280,000
FY 1986	350,000
FY 1987	440,000

1.85 CHILD AND DEPENDENT CARE CREDIT

Minnesota Statutes, Section 290.067

Definition
Minnesota taxpayers are entitled to a refundable credit of from 23% to 30% of dependent care expenses (depending on income), provided that those expenses were necessary in order to hold or look for a job. The maximum credit allowed is $720 for one dependent and $1,440 for two or more dependents. These maximum amounts and allowable percentages are reduced on a sliding scale for taxpayers with incomes over $10,000, so that a taxpayer with a FAGI of over $24,000 will receive no credit. A dependent is defined as a child under age 15, or a person of any age who is disabled.

The dependent care credit was enacted by the Legislature in 1977. It was last revised in 1984.

Fiscal Impact

FY 1984	$ 8,000,000
FY 1985	14,000,000
FY 1986	15,000,000
FY 1987	16,000,000

1.86 CONSTRUCTION FINANCING (ENTERPRISE ZONES)

Minnesota Statutes, Section 273.1314, Subd. 9

Definition
Taxpayers may apply for a credit equal to a percentage of the cost of debt financing for construction of new or expanded facilities in a designated enterprise zone. Each municipality determines the percentage of financing used in computing credit amounts within its zone. Credit amounts in excess of annual tax liability are refundable to the taxpayer.

The credit was enacted in 1983 and was last changed in 1984. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

1.87 TAX CREDITS FOR EMPLOYEES (ENTERPRISE ZONES)

Minnesota Statutes, Section 273.1314, Subd. 9

Definition
An "employee job credit" against income tax may be authorized for individuals employing persons in a designated enterprise zone. The credit may be given for additional (i.e., newly hired) workers employed in the zone, at a rate of $3,000 per new employee. Alternatively, employers located in an enterprise zone that is also designated as a border city may claim a credit of $1,500 per employee for employees who do not qualify the employer for the $3,000 credit. Credit amounts exceeding annual tax liability are refundable to the taxpayer.

The employee job credit was enacted in 1983 and last changed in 1984. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 2: CORPORATION INCOME TAX
AND
BANK EXCISE TAX
INTRODUCTION

The Minnesota corporate income tax was first enacted in 1933 after several unsuccessful attempts to adopt this form of taxation. The original rates ranged from 1% to 5% on income over $10,000. A complementary bank excise tax was adopted in 1941. Current rates of tax for both corporations and banks are 6% on the first $25,000 apportioned to Minnesota and 12% on the remainder. Exemptions from the tax exist for various entities such as nonprofit corporations, cooperative associations and credit unions.

Technically, the Minnesota corporate tax is independent of federal law, although Internal Revenue Code provisions are referenced and followed in many instances. As such, federal corporate taxable income is not specifically used as a starting point for state tax purposes. Insurance companies determine corporate net income under the provisions of the Internal Revenue Code of 1936. The tax base for corporations and banks is net income after subtracting business expenses from gross income. The following shows the computation of the tax for corporations:

	ECONOMIC INCOME	
minus:	EXCLUSIONS	
equals:	GROSS INCOME	Gross Profit Dividend Income Interest Income Rents and Royalties Net Gain or Loss Other Income
minus:	DEDUCTIONS	60% Net Capital Gain Deduction Compensation of Officers Salaries and Wages Repairs Bad Debts Rents Taxes (Not Federal or State Income Taxes) Interest Expense Amortization, Depreciation, and Depletion Advertising Pension and Profit Sharing; Employee Benefit Programs Other Deductions
equals:	TOTAL NET INCOME	
times:	APPORTIONMENT FACTOR	Lesser of: Arithmetic Average of Property, Payroll, and Sales Ratios for Minnesota, or Weighted Factor of 15% of Property and Payroll Ratios Plus 70% of Sales Ratio. (Separate Accounting OR Single Factor Sales Apportionment May Also Be Used.)

equals:	MINNESOTA NET INCOME	
minus:	CONTRIBUTION AND DIVIDEND DEDUCTIONS	
equals:	TAXABLE INCOME	
times:	TAX RATES	
minus:	CREDITS	Research Credit Pollution Control Credit (Reinstated Beginning in 1985) Resource Recovery Credit Small Business Investment Credits
equals:	TAX LIABILITY	
minus:	REFUNDABLE CREDITS	Enterprise Zone Credits Gas Tax Credit
equals:	NET CORPORATE TAX PAYABLE	

Minnesota adopted a domestic unitary method of taxation in 1981. Under the unitary method, a corporation files a combined income return for companies that are part of a unitary business conducted by the taxpayer and related corporations both in and outside of Minnesota. A unitary business constitutes those activities which are of mutual benefit to, dependent upon or contribute to one another, individually or as a group, as evidenced by unity of ownership, operation and use. The combined income approach determines what percentage of unitary business income is properly reportable for state purposes by using formula apportionment. The domestic aspect of unitary taxation means that only corporations organized under U.S. state or federal law are combined into any unitary business group. This type of application of the unitary principle is not considered a tax expenditure.

In fiscal year 1984, net corporate income tax revenues for the state amounted to $275.9 million, or 5.5% of that year's total state tax revenues. Bank excise tax revenues were 0.6% of total state taxes collected in fiscal year 1984. The amount of fiscal year 1984 bank excise tax revenues was $29.6 million. All revenue goes into the general fund.

EXCLUSIONS

2.01 TAX-EXEMPT ORGANIZATIONS

Subchapter F of the Internal Revenue Code; Minnesota Statutes, Section 290.05

Definition
Minnesota conforms to Subchapter F of the I.R.C. in exempting certain types of organizations from taxation. However, while Minnesota totally exempts these organizations from income taxes, the federal government taxes them on their "unrelated business income." Unrelated business income is defined by the I.R.S. as income generated from sources substantially unrelated to the tax-exempt goals of the organization.

Conceptually, the Minnesota tax expenditure is the revenue impact of exempting both related and unrelated business income. In practice, there is no reasonable way to confidently estimate the fiscal impact of exempting related business income. There is a lack of data from which to derive what would be the taxable portion of related business income, and for many nonprofit organizations, such as the March of Dimes, applying the concept of taxable income to their related business income would be very problematical. The revenue impact of exempting unrelated business income from tax, however, can be estimated because federal data exist for that portion of this tax expenditure. The estimates below therefore are a measurement of exempting only that portion of income which is considered by the I.R.S. to be unrelated to the goals of the organization. An example of unrelated business income might be a pharmacy operated by a nonprofit hospital. Selling pharmaceuticals to patients is clearly related to the goals of the organization and such income would not be taxed. However, in the opinion of the I.R.S., selling pharmaceuticals to nonpatients is not substantially related to the goals of the hospital. Income from these latter sales would be considered unrelated business income.

The following is a list of types of organizations which are exempt from Minnesota corporate income tax:

Section of the Internal Revenue Code	Description and Purpose of Tax-Exempt Organization	1983 Total Number of Organizations Nationwide
501 (c) (1)	Federal corporations created by Congress to act as instrumentalities of the United States. Example: Federal Deposit Insurance Corporation	24
501 (c) (2)	Title-holding corporations for exempt organizations. These organizations collect income from the property and turn it back to an exempt organization. One of the reasons why this organization is necessary is because certain states prohibit tax-exempt organizations from holding property.	5,567
501 (c) (3)	Religious, educational, charitable, scientific and literary organizations testing for public safety, fostering certain national or international amateur sports competition, or prevention of cruelty to children or animals. This classification also includes private foundations. Examples: American Heart Association and Ford Foundation	335,757

Section of the Internal Revenue Code	Description and Purpose of Tax-Exempt Organization	1983 Total Number of Organizations Nationwide
501 (c) (4)	Civic leagues, social welfare organizations, and local associations of employees. These organizations promote community welfare or contribute earnings to charitable, educational, or recreational purposes. Example: Lions Club	29,209
501 (c) (5)	Labor, agricultural, and horticultural organizations. These organizations seek to improve working conditions, products, or efficiency through education or instruction. Example: AFL-CIO	79,775
501 (c) (6)	Business leagues, chambers of commerce, real estate boards, and other similar organizations which seek to improve the common business of their members. Examples: A local chamber of commerce and the National Football League.	51,714
501 (c) (7)	Clubs organized for the pleasure, recreation or social activities of their members. Examples: College fraternities and sororities, country clubs, and hobby clubs.	53,467
501 (c) (8)	Fraternal beneficiary societies and associations. These organizations operate under the lodge system and provide life, sickness, and/or accident benefits to their members. Example: Knights of Columbus	88,272
501 (c) (9)	Voluntary employees' beneficiary associations (including federal employee voluntary beneficiary associations formerly covered by section 501(c)(10). These organizations provide for payment of life, sickness, accident, or other benefits to members. Example: Union welfare funds	9,303
501 (c) (10)	Domestic fraternal societies and associations. These organizations are similar to 501 (c) (8) organizations, but do <u>not</u> provide life, sickness, or accident payments to their members. Example: Masons	16,871
501 (c) (11)	Teachers' retirement fund associations. These are organizations of a purely local character which provide for payment of retirement benefits.	12

Section of the Internal Revenue Code	Description and Purpose of Tax-Exempt Organization	1983 Total Number of Organizations Nationwide
501 (c) (12)	Benevolent life insurance associations, mutual ditch or irrigation companies, and mutual or cooperative telephone companies, among others. Example: Tri-County Electric Cooperative	5,125
501 (c) (13)	Cemetery companies owned by and operated exclusively for the benefit of their members. Example: Riverside Cemetery Association	6,412
501 (c) (14)	State chartered credit unions and mutual reserve funds. These organizations provide banking services to their members. Example: State Capitol Credit Union	5,754
501 (c) (15)	Mutual insurance companies or associations which provide insurance to members at cost. (Tax-exempt status is limited to organizations with annual gross incomes of $150,000 or less).	1,017
501 (c) (16)	Cooperative organizations which finance crop operations in conjunction with activities of a marketing or purchasing association.	22
501 (c) (17)	Supplemental unemployment benefit trusts.	771
501 (c) (18)	Employee funded pension trusts (founded prior to June 25, 1959).	3
501 (c) (19)	Recognized posts or organizations of war veterans. Example: American Legion Post	22,130
501 (c) (20)	Trusts to provide for prepaid legal services for employees.	116
501 (c) (21)	Black lung disease trusts	12
501 (c) (22)	Withdrawal liability payment funds. These organizations provide funds to meet the liability of employers withdrawing from a multi-employer pension fund.	Not Available
501 (c) (23)	Associations of past or present members of the Armed Forces, founded before 1880.	Not Available

Section of the Internal Revenue Code	Description and Purpose of Tax-Exempt Organization	1983 Total Number of Organizations Nationwide
501 (d)	Religious and apostolic associations. These organizations provide a common treasury of the regular business activities of a communal religious group.	72
501 (e)	Cooperative hospital associations providing the following services for two or more exempt hospitals: data processing, purchasing, laboratory testing, printing, communications, records center, and personnel services.	98
501 (f)	Cooperative educational service organizations These perform collective investment services for educational organizations.	Not Available
521 (a)	Farmers cooperative associations. These organizations perform cooperative purchasing and marketing of agricultural products.	2,713

Most of these organizations have been exempt from Minnesota income tax since 1933. In 1981 the Legislature chose to conform to the list of tax exempt organizations (outlined above) found in Subchapter F of the I.R.C. The last change occurred in 1984.

Fiscal Impact (Unrelated Business Income Portion Only)

FY 1984	$290,000
FY 1985	320,000
FY 1986	350,000
FY 1987	400,000

2.02 CREDIT UNIONS

Minnesota Statutes, Section 290.05

Definition

Credit unions, which are cooperative associations similar to savings banks, are exempt from both state and federal income taxation. The estimates below are based on the assumption that were they subject to income tax, credit unions would be taxed the same as building and loan associations.

Credit unions have been specifically excluded from state income taxation since 1937. In 1981, Minnesota adopted the language found in Subchapter F of the I.R.C. which excludes numerous organizations, including credit unions, from income tax. Although the exclusion of credit unions from the income tax has been treated separately here, the general topic of tax-exempt organizations, as defined in Subchapter F of the I.R.C. is also discussed in item 2.01 above.

Fiscal Impact

FY 1984	$ 900,000
FY 1985	1,000,000
FY 1986	1,200,000
FY 1987	1,300,000

2.03 DEFERRAL OF INCOME FROM CONTROLLED FOREIGN CORPORATIONS

Internal Revenue Code, Sections 11(d), 882, and 951-964; Minnesota Statutes, Section 290.52

Definition
Generally, when a domestic corporation controls another domestic corporation, income of the subsidiary corporation is attributed to the parent corporation. However, when a domestic corporation controls a foreign corporation, income of the controlled foreign corporation (CFC) is not taxed until it is repatriated to the parent corporation. Income from CFC's may therefore be deferred from taxation indefinitely as long as it is reinvested in the CFC or some other foreign subsidiary of the parent corporation.

The estimates below measure the impact of this deferral. The effect of the dividends received deduction (item 2.19), which excludes from corporate income 85% of dividends received from another corporation, was included in the estimates.

Minnesota has always allowed parent corporations to defer income from CFC's until it is repatriated. In 1962 Congress first enacted legislation affecting CFC's. Minnesota closely follows the federal definition.

Fiscal Impact

FY 1984	$ 970,000
FY 1985	1,100,000
FY 1986	1,100,000
FY 1987	None

2.04 UNRELATED INCOME (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Minnesota taxes insurance companies on three types of income: interest, dividends and rent. All other income, including income from non-insurance business activities, is excluded from taxable income. The estimates below are for unrelated income only; other types of excluded income are discussed in items 2.05, 2.06, and 2.07.

The state first taxed insurance companies in 1937. Unrelated income has been excluded from the corporate income tax since then.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.05 UNDERWRITING INCOME (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Life insurance companies may exclude from Minnesota taxable income all "underwriting income" earned in a taxable year. Underwriting income is defined as a life insurance company's total gain from operations, minus the company's taxable investment income. Underwriting income is chiefly made up of the following two types of income: (1) mortality savings, which are realized when deaths occur at a rate less than was assumed when life insurance premiums and reserves were established; and (2) loading savings, which are realized when expenses incurred in placing insurance policies on the books, and subsequently servicing them, are lower than was anticipated.

Insurance companies were originally exempt from the Minnesota income tax when it was enacted in 1933. In 1937, the state adopted a portion of the federal Revenue Act of 1936 dealing with the taxation of insurance companies. This act, which is still used by the state, imposed an income tax on insurance companies, but excluded underwriting income. The federal government began including half of a company's underwriting income in taxable income in 1959.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.06 FEE INCOME (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Life insurance companies may exclude from taxable income any fees received during the taxable year. Examples of fees collected by life insurance companies are partial release fees, loan assumption fees, rent collection fees, mortgage loan commitment fees, and income cancellation mortgage loan commitment fees.

Life insurance companies were first subject to the Minnesota corporate income tax in 1937. Fee income has been excluded since that time.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.07 ROYALTIES (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Minnesota life insurance companies may exclude from taxable income all royalties received during the year.

The royalties of life insurance companies have been excluded from taxation since 1937.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

DEDUCTIONS

2.08 FOREIGN SOURCE DIVIDENDS

Minnesota Statutes, Section 290.21, Subd. 4(e)

Definition
Effective for tax years beginning after July 1, 1985, dividends may be excluded from gross income if they are received from a corporation organized under the laws of a foreign country or political subdivision. Excluded dividends must be paid from income arising from sources outside the United States, the Commonwealth of Puerto Rico, or the possessions of the United States.

Since the bulk of foreign dividends may be deducted under the more general dividends received deduction (see item 2.19), shown below is the fiscal effect of excluding only the remaining portion of foreign dividends.

This exclusion was enacted in 1984 and becomes effective for tax years beginning after June 30, 1985.

Fiscal Impact

FY 1984	None
FY 1985	None
FY 1986	None
FY 1987	$4,000,000

2.09 FOREIGN SOURCE ROYALTIES

Minnesota Statutes, Section 290.21, Subd. 8

Definition
For tax years beginning after December 31, 1984, corporations may deduct from taxable net income, prior to apportionment, amounts received from a foreign corporation as rentals, fees, and royalties. The payments received must be for the use or privilege of using outside the United States, "patents, copyrights, secret processes and formulas, good will, know-how, trademarks, trade brands, franchises, and other like property." In order to claim this deduction a corporation must receive at least 80% of its gross income from the above sources.

This provision was enacted by the Legislature in 1984.

Fiscal Impact

FY 1984	None
FY 1985	None
FY 1986	$5,700,000
FY 1987	6,700,000

2.10 SIXTY PERCENT CAPITAL GAINS DEDUCTION

Minnesota Statutes, Section 290.16, Subd. 4

Definition
Sixty percent of a taxpayer's net long-term capital gains in excess of net short-term capital losses may be deducted from gross income. The remaining forty percent of net long-term gains is taxable income, to be taxed at the normal rates. Although no concise definition of capital asset exists, generally speaking, invest-

ments are capital assets (for tax purposes) and inventory held for retail sale is not. To be long-term, the gain must result from the sale or exchange of assets held by the taxpayer for one year or longer. Assets held for less than one year generate short-term capital gains or losses. Short-term capital gains do not qualify for the 60% deduction. (It should be noted that the minimum holding period for long term gains/losses has recently been reduced to six months for federal tax purposes.)

This provision was enacted by the Legislature in 1945, with the last statutory change occurring in 1982, when the deduction was increased to 60% from 50%.

Fiscal Impact

FY 1984	$19,000,000
FY 1985	23,000,000
FY 1986	24,000,000
FY 1987	24,000,000

2.11 SAFE-HARBOR LEASING (DEPRECIATION COMPONENT) (REPEALED)

Internal Revenue Code, Section 168(f)(8); Minnesota Statutes, Section 290.09, Subd. 7

Definition

Prior to 1981, I.R.S. guidelines required that a taxpayer have a capital interest in a leased property in order to claim a depreciation deduction. This meant that only the actual owner of a property could claim the deduction. In 1981, Congress passed legislation allowing for "safe-harbor leasing," which permits a corporation with little or no basis in a property to behave, for tax purposes, as though it were the owner of the property. Essentially, this provision allows a corporation with depreciation deductions exceeding its tax liability to "sell" its deductions to a corporation which does have a tax liability.

For lease agreements entered into after December 31, 1983, safe-harbor leasing will no longer be permitted. In its place Congress created a new type of leasing called "finance leasing." Under this new provision, a corporation must again have a capital interest in an asset to claim a depreciation deduction.

Congress enacted this deduction in 1981. Minnesota adopted the federal treatment of safe-harbor leases in that year. The provision is repealed for lease agreements entered into after December 31, 1983.

Fiscal Impact

FY 1984	$5,300,000
FY 1985	4,900,000
FY 1986	4,000,000
FY 1987	5,200,000

2.12 DEPRECIATION

Internal Revenue Code, Section 168; Minnesota Statutes, Section 290.09, Subd. 7

Definition

Minnesota taxpayers are allowed a deduction for depreciation of property (other than land) used in a trade or business or held for the production of income. Depreciation is an attempt to measure an asset's decline in value due to use, wear, or decay within the tax year. The deduction is intended to match current expenses with current income. Conceptually, the tax expenditure is the extent that depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. The estimates below measure the extent to which current depreciation allowances exceed actual declines in value as measured by 35 year straight line depreciation for real property and class life asset depreciation ranges (CLADR) for personal property.

The depreciation deduction was a part of the original Minnesota income tax in 1933. Accelerated depreciation was first allowed through administrative practice by the federal government in 1946, and by law in 1954. Minnesota first enacted an accelerated depreciation provision in 1959. The last change to the state's provision occurred in 1984.

Fiscal Impact

FY 1984	$21,000,000
FY 1985	20,000,000
FY 1986	19,000,000
FY 1987	19,000,000

2.13 EXCESS OF PERCENTAGE OVER COST DEPLETION FOR COPPER-NICKEL MINING

Internal Revenue Code, Sections 613 and 614; Minnesota Statutes, Section 290.09, Subd. 8 and 9

Definition
Minnesota corporate taxpayers may take a percentage depletion allowance, rather than a cost depletion allowance, for copper-nickel mining. Depletion allowance refers to the way in which investment costs are recovered for mining or other extractive operations. Cost depletion deductions are allowed on such diverse properties as oil and gas wells, mineral mines, peat bogs, clay mines, gravel quarries and commercial stands of timber. In fact, cost depletion deductions may be taken for almost all exhaustible natural resources. Although the federal government allows percentage depletion for most exhaustible resources, the state allows it only for copper-nickel mining.

Briefly, the two forms of depletion may be explained as follows: Cost depletion is based on the taxpayer's basis in the property and is almost identical to depreciation in its application. Percentage depletion, on the other hand, is based on a percentage of the gross income received from the extractive operation and has little relationship to a taxpayer's basis. Because cost depletion is a normal and necessary cost of doing business, only the amount of percentage depletion allowed over and above what cost depletion would allow is considered a tax expenditure.

Minnesota first allowed percentage depletion for copper-nickel mining in 1967. This provision was last changed in 1981.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.14 AMORTIZATION OF ORGANIZATIONAL AND START-UP COSTS

Internal Revenue Code, Sections 195 and 248; Minnesota Statutes, Section 290.09, Subd. 19

Definition
Corporations which incur certain expenses during their initial organization or start-up phase may elect to amortize those costs over a period of not less than 60 months, beginning in the month in which the corporation commences operations. Without this special provision, corporate taxpayers would be required to capitalize the costs, adding them to their basis.

Minnesota first adopted the deduction for organizational expenses in 1955. The deduction for start-up costs was added in 1980.

Fiscal Impact

FY 1984	Minimal
FY 1985	$110,000
FY 1986	130,000
FY 1987	150,000

2.15 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174; Minnesota Statutes, Section 290.09, Subd. 18

Definition
Corporations may elect to expense in the current tax year all qualified research and development costs. If the asset resulting from the research or development expenditures has no determinable useful life (such as is the case with a process or a secret formula), then the taxpayer may alternatively elect to amortize the costs over not less than 60 months.

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. This provision is a tax expenditure to the extent that it allows immediate or accelerated deductions which defer present tax liability into future years.

No substantial changes have been made to this provision since it was enacted by Congress in 1954 and adopted by the state in 1955.

Fiscal Impact

FY 1984	$8,300,000
FY 1985	8,500,000
FY 1986	8,700,000
FY 1987	8,900,000

2.16 EXPENSING OF MINERAL EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 616 and 617; Minnesota Statutes, Section 290.09, Subd. 25

Definition
Minnesota allows corporate taxpayers to expense mineral exploration and development costs (except oil and gas) in the year the costs are incurred. Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current-year expenses. These costs are normally capital expenses, used to increase the taxpayer's basis in the property. The current-year expensing of exploration and development costs acts to reduce current-year ordinary income. For mine development costs, future income is somewhat increased because of certain recapture provisions, but the amount of the future increases are generally less than the current deduction. Current-year expensing is allowed for such items as labor costs, ground clearing, construction, and other site-preparation costs incurred in the exploration and development of mineral deposits.

Expensing of exploration and development costs for all minerals was first allowed by Minnesota in 1967.

Fiscal Impact

FY 1984	$120,000
FY 1985	130,000
FY 1986	150,000
FY 1987	170,000

2.17 EXPENSING OF CERTAIN CAPITAL OUTLAYS AND SPECIAL CASH ACCOUNTING RULES FOR FARMERS

Internal Revenue Code, Section 175; Minnesota Statutes, Section 290.09, Subd. 21; and Minnesota Rules, Part 8001.0500, Subp. 7, and Part 8009.1300

Definition
Agricultural-based income is given special tax treatment in Minnesota. This tax expenditure involves two of the ways that is done. First, by permitting the cost of capital outlays to be deducted in the year incurred, instead of throughout an asset's useful life; and second, by mismatching income and expenses. Both treatments result in lower current-year tax liabilities for corporate farmers.

In general, the special treatment allowed corporate taxpayers is the same as that which is allowed individual taxpayers (item 1.44) except that the corporate provisions are somewhat more restrictive. Capital expenditures which are given special treatment include those made for soil and water conservation, land clearing, and land improvement projects. Also, by allowing certain nurseries and family corporations to use the cash accounting system rather than the accrual system, the state allows taxpayers to deduct costs attributable to goods not yet sold, thereby deferring tax liability into successive years. The accrual system is normally required under tax law when the sale of products is a material factor of a corporation's business, and is required for most agricultural corporations other than nurseries and family corporations.

Certain agricultural corporations have been allowed to use the cash accounting system for tax purposes since 1933. Minnesota began allowing the expensing of capital outlays in 1955.

Fiscal Impact

FY 1984	$550,000
FY 1985	580,000
FY 1986	610,000
FY 1987	620,000

2.18 CHARITABLE CONTRIBUTIONS

Minnesota Statutes, Section 290.21, Subd. 1 and 3

Definition
Minnesota banks and corporations may deduct from taxable net income charitable, public purpose, religious, scientific, literary, artistic, or educational contributions made in a taxable year. The contribution deduction is limited to 15% of the taxpayer's net income less the deduction allowed for dividends received; no carryovers are allowed. If contributions are made to non-Minnesota recipients, taxpayers may deduct only a portion of contributions equal to Minnesota taxable net income over total U.S. net income.

This deduction was enacted in 1933 and last changed in 1983.

Fiscal Impact

FY 1984	$7,800,000
FY 1985	8,400,000
FY 1986	9,000,000
FY 1987	9,600,000

2.19 DIVIDENDS RECEIVED DEDUCTION

Minnesota Statutes, Section 290.21, Subd. 4

Definition
Under certain conditions a corporation or bank may deduct from its taxable net income either 85% or 100% of dividend income it receives from other corporations. Generally, the conditions relate to the nature or type of corporation receiving the dividends, the purpose for which the stocks are held, and the relationship between the dividend recipient and the dividend paying companies.

Effective for tax years beginning after July 1, 1985, all dividends received from a corporation organized under the laws of a foreign country may be excluded from income (see item 2.08). The estimates below reflect the exclusion of foreign source dividends to the extent that they qualify for exclusion under this provision. The estimates for item 2.08 reflect the balance of foreign source dividends which are not already excluded by this provision.

The dividends received deduction was enacted in 1947 and was last changed in 1984.

Fiscal Impact

FY 1984	$28,000,000
FY 1985	34,000,000
FY 1986	35,000,000
FY 1987	20,000,000

2.20 WEIGHTED APPORTIONMENT

Minnesota Statutes, Section 290.19

Definition
Minnesota allows corporate taxpayers to apportion their income to Minnesota by using either an equally weighted three-factor formula or an unequally weighted three-factor formula, at the taxpayer's option.

The following three factors are included in both formulas:

1. The percentage of a corporation's total sales which are Minnesota sales;
2. The percentage of total property owned or rented which is located in Minnesota; and
3. The percentage of total payroll which is for labor performed in Minnesota.

The equal weight formula treats each of these three factors equally in assigning a corporation's income to Minnesota. The optional formula, however, assigns a 70% weight to sales, a 15% weight to property, and a 15% weight to payroll. Because the effect of the optional formula is to lower Minnesota tax liability for certain corporations having sales outside the state, the option is viewed as a tax expenditure.

Minnesota first allowed manufacturing firms the option to choose between the two formulas in 1939. Non-manufacturing firms were given the same option in 1953. This provision was last changed in 1982.

Fiscal Impact

FY 1984	$72,000,000
FY 1985	88,000,000
FY 1986	90,000,000
FY 1987	90,000,000

2.21 THROWBACK SALES

Minnesota Statutes, Section 290.19, Subd. 1a

Definition
Multistate corporate taxpayers are not required to include "throwback sales" in their Minnesota sales when apportioning income to Minnesota for tax purposes. Throwback sales are defined as sales of goods from Minnesota offices, stores, warehouses, and factories to either the federal government, or to a purchaser in another state if the other state does not impose an income tax on the seller. Because apportionment of Minnesota income from total income is in large part determined by the ratio of Minnesota sales to total sales (see item 2.20), this provision results in corporations having less Minnesota tax liability than would otherwise be the case.

Prior to 1973 Minnesota used an origin-of-sale basis for corporate apportionment. In 1973, when Minnesota switched to a destination-of-sale basis, throwback was not adopted.

Fiscal Impact

FY 1984	$24,000,000
FY 1985	24,000,000
FY 1986	24,000,000
FY 1987	24,000,000

2.22 NET OPERATING LOSS (CARRYBACK/CARRYOVER)

Minnesota Statutes, Section 290.095

Definition
A net operating loss occurs when a corporation or bank has certain deductions in excess of gross income for the tax year. The net operating loss may be carried back up to three years and carried forward up to five years and deducted from taxable income in those years. The net operating loss may not, however, be used to create a loss in the year to which it is carried.

This provision was enacted in 1945 and was last changed in 1984.

Fiscal Impact

FY 1984	$27,000,000
FY 1985	32,000,000
FY 1986	37,000,000
FY 1987	38,000,000

2.23 DEDUCTIONS ALLOWING CORPORATIONS TO BE TAXED AS A PARTNERSHIP

Minnesota Statutes, Section 290.21, and 290.9726

Definition
Generally, all corporations doing business within the state are subject to the corporate income tax "for the privilege of existing as a corporation. . .". However, certain types of corporations may elect to take deductions, effectively causing them to be taxed as partnerships. Income earned by a partnership is normally not taxable to the partnership, but instead is taxable to the individual partners under the individual income tax. Electing to be taxed as a partnership is a tax expenditure to the extent that it allows corporations to deduct from gross income amounts distributed to shareholders, which would otherwise be subject to the corporate income tax. The following three types of organizations may elect to receive this special tax treatment.

S Corporations: Also known as subchapter S, tax-option, or small business corporations, these corporations must meet certain requirements in order to qualify for the preferential tax status including:

- Only one class of stock
- Domestic corporations only
- Only individuals as shareholders
- No more than 35 shareholders
- All shareholders unanimously elect to special status

Termination of special status will occur if the corporation fails to meet the standards above, or if those controlling more than 50% of the voting shares agree to revocation.

Real Estate Investment Trusts (REIT's): REIT's are involved in a number of activities, including operation of rental property and the granting of loans. Qualified REIT's may deduct from gross income all amounts distributed to shareholders. Any income retained by the REIT is subject to the corporate income tax.

Regulated Investment Companies (RIC's): RIC's engage primarily in the business of investing, reinvesting, or trading of stocks and securities. RIC's may elect to be treated as a partnership for tax purposes provided that at least 90% of the corporation's gross earnings are from dividends, interest or are gains from the sale of stocks or securities, and provided that less than 30% of the corporation's income is derived from securities held less than three months. By electing special status, RIC's are able to deduct from gross income all amounts distributed to shareholders. However, income retained by the RIC is still subject to the corporate income tax. Once an election is made for an RIC, it is irrevocable for the current and all succeeding taxable years.

Special tax status was first allowed for RIC's in 1941, S Corporations in 1961, and REIT's in 1971. The last change affecting any of these provisions took place in 1984.

Fiscal Impact

	S Corporations	REIT's	RIC's	Total
FY 1984	$11,000,000	$280,000	$22,000,000	$33,280,000
FY 1985	14,000,000	300,000	24,000,000	38,300,000
FY 1986	14,000,000	320,000	27,000,000	41,320,000
FY 1987	16,000,000	350,000	30,000,000	46,350,000

2.24 EXCESS RESERVES FOR BAD DEBT (BANKS)

Minnesota Statutes, Section 290.09, Subd. 6 (c)

Definition

As a general rule, "bad debt" deductions are a necessary cost of doing business which arise when a taxpayer uses the accrual method of accounting. Under the accrual method, a taxpayer includes as income all amounts that it has earned the right to receive. A bad debt deduction reduces accrued income for amounts which will never be received.

A bank may choose one of two ways to compute its bad debt deduction: 1) the specific charge-off method; or 2) the reserve method. Under the charge-off method, a deduction is taken by a bank at the time a debt becomes worthless. Under this method there is no overstatement of the bad debt deduction, and no tax expenditure. Under the reserve method, deductions are taken when funds are added to a reserve account which is subsequently reduced as debts become worthless. When the balance of the reserve account exceeds zero at the end of a tax year, total deductions taken will have exceeded a taxpayer's accumulated losses. This tax expenditure is defined as the extent to which tax liability has been reduced beyond what it would have been using the charge-off method.

Both the state and federal governments place ceilings on the amount a financial institution may add to its bad debt reserves. Ceilings are based on such things as the type of institution, the type of loans the institution has outstanding, and the past history of the institution. The ceilings serve to limit the tax expenditure but do not eliminate it.

The federal government first allowed banks to establish bad debt reserves in 1947. Minnesota enacted a specific charge-off type of bad debt deduction in 1949, and first allowed the reserve method in 1959, when the federal language was partially incorporated into Minnesota law. This provision was last changed in 1963.

Fiscal Impact

FY 1984	$4,500,000
FY 1985	5,600,000
FY 1986	6,100,000
FY 1987	7,100,000

2.25 PATRONAGE DIVIDENDS (COOPERATIVES)

Minnesota Statutes, Section 290.08, Subd. 12

Definition
Cooperative buying, selling, or producing associations may exclude from gross income amounts which are distributed to customers (patrons) in the form of patronage dividends. This exclusion applies to both cash and noncash dividends. Cooperatives may retain up to 80% of their earnings beyond the end of the tax year in this fashion without paying any income tax. This provision effectively exempts cooperatives from corporate income taxation. However, both cash and noncash dividends are treated as taxable income to the patron.

Minnesota has excluded patronage dividends from the income of cooperatives since 1933.

Fiscal Impact

FY 1984	$6,400,000
FY 1985	6,600,000
FY 1986	6,800,000
FY 1987	7,000,000

2.26 EXEMPT INTEREST (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Insurance companies may take a deduction for interest income which they receive by virtue of holding interest-bearing debt obligations of a state, territory, possession of the United States, or of any political subdivision of the foregoing.

This provision was enacted in 1937 and remains unchanged.

Fiscal Impact

FY 1984	$730,000
FY 1985	810,000
FY 1986	890,000
FY 1987	970,000

2.27 SUMS PAID OUT OTHER THAN DIVIDENDS (MUTUAL INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Mutual insurance companies may take a deduction from net income for all sums paid out other than dividends. Certain sums paid out, such as payments on claims, are deemed to be ordinary and necessary business expenses and their deduction is not viewed as a tax expenditure. Other sums paid out represent special treatment and their deduction is considered a tax expenditure. Examples of the latter include liabilities for unearned premiums and company surplus. Liabilities for unearned premiums are amounts maintained in a reserve fund which are considered to be owed policyholders for the coverage that they have yet to receive from the company. Company surplus is excess premiums or overcharges paid to the insurance company by the policyholders. Annual liability is affected when these sums are held for more than one tax year before being refunded to the policy-holders. Therefore, they constitute a form of retained earnings which are not taxed and their deduction is considered a tax expenditure.

This provision was enacted in 1937 and has not been changed since then.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.28 MEAN RESERVES (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Depending on certain conditions, life insurance companies are allowed a deduction from gross income of either three and three-quarters percent or four percent of the mean of reserve funds held at the beginning and end of the taxable year. Reserve funds are required by state law for most types of life insurance policies in order to protect policyholders. The conditions affecting the deduction involve interest rates, the types of policies issued, and determinations made by the Commissioner of Revenue.

The provision was enacted in 1937 and has not been changed since that time.

Fiscal Impact

FY 1984	$8,400,000
FY 1985	9,000,000
FY 1986	9,500,000
FY 1987	10,000,000

2.29 RESERVES FOR DEFERRED DIVIDENDS (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Definition
Life insurance companies may take a deduction, in addition to the deduction allowed for all business expenses, equal to two percent of all qualified funds held at the end of a taxable year as a reserve for payment of deferred dividends. Qualifying funds must be for dividend payments which are deferred for not less than five years from the date of the policy contract.

This provision was enacted in 1937 and has not been changed since.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CREDITS

2.30 POLLUTION CONTROL CREDITS

Minnesota Statutes, Section 290.06, Subd. 17 and 18

Definition
For tax years beginning after December 31, 1984, corporate taxpayers may take a nonrefundable credit for the purchase of pollution control devices intended to "prevent, control, or abate pollution," or reduce the generation of hazardous waste, within Minnesota. Two categories of pollution control equipment qualify for separate credits.

The first credit is given for equipment purchased which is generally used to "abate or control pollutants to meet or exceed state laws, rules, or standards," or used for the reduction of hazardous waste generation. The credit amount is equal to five percent of the cost of the equipment. Although the maximum credit amount for any one tax year cannot exceed tax liability or $75,000, whichever is less, any unused credit may be carried forward for up to four succeeding years.

The second type of pollution control credit is for the purchase of feedlot pollution control equipment. These devices are used for the prevention of air, water, or land pollution resulting from the operation of livestock, poultry, or animal lots. Qualified expenses include those incurred in the purchase of lagoons, concrete storage pits, or slurry handling equipment. The credit amount is equal to ten percent of the cost of the equipment. As above, any credit amount which exceeds the current tax liability of the taxpayer may be carried forward for up to four years. However, unlike the credit above, there is no dollar limit to this credit.

The pollution control credit was first enacted by the Minnesota Legislature in 1969 and was repealed in 1983. The feedlot credit was first enacted in 1971 and was repealed in 1983. In 1984, the Legislature re-enacted the feedlot pollution control credit and the regular pollution control credit, expanding the latter to include hazardous waste abatement equipment for the first time.

Fiscal Impact

FY 1984	$ 500,000
FY 1985	150,000
FY 1986	1,100,000
FY 1987	1,100,000

2.31 RESOURCE RECOVERY EQUIPMENT CREDIT

Minnesota Statutes, Section 290.06, Subd. 16

Definition
Beginning in tax year 1984, Minnesota corporate taxpayers may claim a nonrefundable credit of up to ten percent of the costs incurred in purchasing qualifying equipment used for processing solid or hazardous waste at a resource recovery facility. Unlike the credits presented in item 2.30, this credit is not for the cost

of equipment used to "prevent, control, or abate" pollution, or to reduce the generation of hazardous wastes in Minnesota; it may be claimed only for purchases of pollution processing equipment which is used at a resource recovery facility.

Currently no hazardous waste recovery facilities are located in the state, and there is no indication that such a facility will be built over the time span of this study. Therefore, the estimates below apply only to purchases of solid waste processing equipment. Qualifying equipment includes that used for incineration, recycling, and composting. Although the credit is nonrefundable, any excess credit amount may be carried forward for up to four succeeding years.

This provision was enacted by the Minnesota Legislature in 1984.

Fiscal Impact

FY 1984	None
FY 1985	$480,000
FY 1986	480,000
FY 1987	480,000

2.32 ENERGY CREDIT (REPEALED)

Minnesota Statutes, Section 290.06, Subd. 14

Definition
From 1979 through 1983, corporations could claim a credit against income tax equal to twenty percent of the first $10,000 spent on biomass conversion equipment which was located in Minnesota, and which produced ethanol, methane, or methanol from various crops, wastes, and byproducts. In 1984, the Legislature repealed this credit for corporations but it continues for two more years for individual taxpayers (see item 1.78).

This provision was enacted in 1979 and repealed in 1984.

Fiscal Impact

FY 1984	Minimal
FY 1985	None
FY 1986	None
FY 1987	None

2.33 CONSERVATION TILLAGE EQUIPMENT CREDIT

Minnesota Statutes, Section 290.06, Subd. 19

Definition
Effective with taxable years beginning after December 31, 1984, corporate taxpayers may claim a nonrefundable credit equal to ten percent of the net cost of qualified conservation tillage equipment. Qualified equipment includes conservation tillage planters and planting attachments designed to plant row or small grain crops under the no-till, ridge-till, or strip-till methods of conservation tillage. The amount of the current-year credit which is in excess of current-year liability may be carried back for up to three years or forward for up to five years.

This credit was enacted in 1984.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

2.34 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

Definition
A corporate taxpayer may claim a nonrefundable credit against the income tax based on qualified expenditures for research and development performed solely within Minnesota. Expenditures include such things as wages paid to researchers, costs of supplies used in conducting research, rental costs of personal property used in research, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota. Current-year expenditures must exceed the average yearly research and development expenditures for the three preceding years to qualify. This average of the preceding three years is referred to as the base-year expenditure.

The credit is equal to 12.5% of the first $2,000,000 of current-year expenditures over the base-year expenditure. A credit equal to 6.25% is allowed for amounts in excess of $2,000,000 over the base year. The credit claimed may not exceed the taxpayer's current tax liability. However, credit in excess of current tax liability may be carried forward 15 years and back three years.

The research and development credit was enacted in 1981, effective beginning with tax year 1982. It was last changed by the Legislature in 1983.

Fiscal Impact

FY 1984	$7,300,000
FY 1985	7,400,000
FY 1986	7,500,000
FY 1987	7,600,000

2.35 CONSTRUCTION FINANCING (ENTERPRISE ZONES)

Minnesota Statutes, Section 273.1314, Subd. 9(a)(3)

Definition
Businesses may apply for a credit equal to a percentage of the cost of debt financing for construction of new or expanded facilities in a designated enterprise zone. Each municipality determines the percentage of financing used in computing credit amounts within its zone. Credit amounts in excess of annual tax liability are refundable to the taxpayer.

The credit was enacted in 1983 and was last changed in 1984. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

Fiscal Impact

FY 1984	Minimal
FY 1985	$340,000
FY 1986	190,000
FY 1987	190,000

2.36 TAX CREDITS FOR EMPLOYEES (ENTERPRISE ZONES)

Minnesota Statutes, Section 273.1314, Subd. 9

Definition
An "employee job credit" against income tax may be authorized for businesses located in a designated enterprise zone. The credit may be given for additional (i.e., newly hired) workers employed by the business in the zone, at a rate of $3,000 per new employee. Alternatively, businesses located in an enterprise zone that

is also designated as a border city may claim a credit of $1,500 per employee for employees which do not qualify the employer for the $3,000 credit. Credit amounts exceeding annual tax liability are refundable to the taxpayer.

The employee job credit was enacted in 1983 and last changed in 1984. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

Fiscal Impact

FY 1984	$1,300,000
FY 1985	2,400,000
FY 1986	2,000,000
FY 1987	2,000,000

2.37 CREDIT FOR TECHNOLOGY TRANSFERS TO SMALL BUSINESSES (REPEALED)

Minnesota Statutes, Section 290.069, Subd. 2 and 6

Definition
For tax years 1984 and 1985, Minnesota corporate taxpayers may claim a nonrefundable credit against income tax liability in an amount equal to 30% of the net value of "technology" transferred to a qualified small business, up to a maximum credit of $300,000. Technology refers to "a proprietary process, formula, pattern, device, or compilation of scientific or technical information." Several restrictions limit the scope of this credit, including: (1) the technology cannot be in the public domain; (2) the technology must have a definable value; (3) the receiver of the technology must make a "substantial investment" in acquiring the technology; and (4) the credit cannot be claimed for technology transferred to a subsidiary or affiliate of the taxpayer.

This credit was enacted in 1983 and expires for all contributions made after December 31, 1985.

Fiscal Impact

FY 1984	None
FY 1985	$900,000
FY 1986	900,000
FY 1987	None

2.38 CREDIT FOR CONTRIBUTIONS TO SMALL BUSINESS ASSISTANCE OFFICES (REPEALED)

Minnesota Statutes, Section 290.069, Subd. 3 and 6

Definition
Minnesota corporate taxpayers may claim a credit against tax for contributions to a "small business assistance office" or to an "innovation center public corporation," provided that contributions are made in tax years beginning on or after January 1, 1984, and before December 31, 1985. The credit amount is equal to 50% of the contribution up to a maximum credit amount of $25,000.

A small business assistance office is a nonprofit corporation which provides assistance and training to individuals who are financing, developing, or establishing qualified small businesses. In order to qualify for this provision, the small business assistance office must meet certain requirements and be certified by the Minnesota Department of Energy and Economic Development. An innovation center public corporation is a nonprofit public corporation located at a Minnesota state university that has as its purpose encouraging and assisting Minnesota high-technology small businesses.

This credit was enacted in 1983. It is repealed for all contributions made in tax years beginning after December 31, 1985.

Fiscal Impact

FY 1984	None
FY 1985	$230,000
FY 1986	230,000
FY 1987	None

2.39 CREDIT FOR EQUITY INVESTMENT IN A SMALL BUSINESS (REPEALED)

Minnesota Statutes, Section 290.069, Subd. 4 and 6

Definition
Corporate taxpayers may claim a credit equal to 30% of their net investment in excess of $25,000 in the equity stock of a qualified small business. The amount of credit that may be used in one year is limited to $75,000 or 75% of the taxpayer's tax liability after the subtraction of all other credits, whichever is less. Additionally, the credit may not be taken if a taxpayer owns more than 49% of the small business' stock, or if the stock pays fixed or variable interest rates. If the small business is located within an enterprise zone, credit may be taken for equity investments in excess of $10,000, up to a maximum credit amount of $100,000.

A qualified small business is one which has been certified by the Commissioner of Energy and Economic Development as having met an established set of criteria. Any unused credit amounts may be carried forward for up to five years. No carryback is allowed.

This credit was enacted in 1983, effective for tax years 1984 and 1985. The provision expires for tax years beginning after December 31, 1985.

Fiscal Impact

FY 1984	None
FY 1985	$1,300,000
FY 1986	1,300,000
FY 1987	Minimal

2.40 CREDIT FOR GROSS PREMIUMS TAX (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.06, Subd. 3f(6)

Definition
Minnesota insurance companies may take a credit against income tax for the amount of Minnesota gross insurance premiums tax paid during the tax year.

This credit was enacted in 1937.

Fiscal Impact

FY 1984	$20,000,000
FY 1985	25,000,000
FY 1986	25,000,000
FY 1987	25,000,000

2.41 MINNESOTA COMPREHENSIVE HEALTH ASSOCIATION ASSESSMENT CREDIT (INSURANCE COMPANIES) (REPEALED)

Minnesota Statutes, Section 62E.11, Subd. 8

Definition
All Minnesota insurance companies, in order to do business within the state, are required to belong to the Minnesota Comprehensive Health Association. The Minnesota Comprehensive Health Association is a state agency which makes an annual assessment on each member insurance company based on the company's Minnesota gross premiums. Prior to January 1, 1984, a nonrefundable credit, equal to the assessment, could be claimed against either the insurance company's income tax liability or its gross premiums tax liability, but not both. After January 1, 1984, the credit may be claimed against gross premiums tax liability only. For this reason the estimate below is for fiscal year 1984 only. The impact of the credit against gross premiums tax may be seen in item 12.06.

This credit was enacted in 1979. The option allowing taxpayers to take the credit against income tax was repealed in 1984.

Fiscal Impact

FY 1984	$130,000
FY 1985	None
FY 1986	None
FY 1987	None

CHAPTER 3: ESTATE TAX

INTRODUCTION

Minnesota first began taxing the estates of decedents in 1905 when the Legislature enacted an inheritance tax with graduated rates from 1.5% to 5%. The inheritance tax applied to each individual who received property from an estate and varied with the amount of property received and the recipient's relationship to the decedent. Exemptions and rates were increased periodically throughout the years with exemptions being substantially increased, particularly for surviving spouses in 1976.

In 1979, the Minnesota Legislature made a major change in the area of death taxation by repealing the inheritance tax and adopting an estate tax similar to that imposed by the federal government. The tax base for the Minnesota estate tax is now the gross estate of a decedent at the time of death less reasonable and necessary costs of administering the estate. In other words, the estate tax applies to the entire taxable estate regardless of who receives the property.

The 1981 Economic Recovery Tax Act, passed by the U.S. Congress, made significant changes to the federal estate tax. Minnesota has adopted conforming legislation to remove the limit on the marital deduction and to increase, over a six year period, the minimum filing requirement and the general estate deduction. The lower end of the rate schedule has also been adjusted each year to correspond to changes in the minimum filing requirement.

For estates of decedents who died in 1984, a Minnesota estate tax return was due if the decedent's federal gross estate was $325,000 or more and the decedent was either a Minnesota resident or owned property located within the state. The return is filed by the estate's personal representative and is due nine months after the date of death.

By 1987, a return will be required only if a decedent's federal gross estate exceeds $600,000. This will cause a reduction in the number of returns filed annually and the amount of tax collected. Consequently, the estate tax expenditures have estimated revenue impacts which tend to decrease each year as fewer taxpayers are affected.

Computation of Minnesota estate tax

	GROSS ESTATE (The value of all property owned by the decedent at the time of death)
minus:	EXCLUSIONS FROM FEDERAL GROSS ESTATE (Property not required to be reported)
equals:	FEDERAL GROSS ESTATE (Reported on federal return)
minus:	NON-MINNESOTA PROPERTY
equals:	MINNESOTA GROSS ESTATE
minus:	EXEMPTIONS and DEDUCTIONS
equals:	MINNESOTA TAXABLE ESTATE
times:	GRADUATED RATES (From 8% To 12% for 1984)
minus:	CREDITS
equals:	CALCULATED MINNESOTA ESTATE TAX (or federal credit amount for state death taxes, whichever is greater)

The actual amount of Minnesota estate tax due is the greater of an amount computed from the Minnesota rate schedule or the federal credit for state death taxes from the federal return. In 1982, 46% of estate tax returns (1,218) showed a tax amount payable. Of that 46%, approximately one-half paid a tax based on the federal credit amount.

A total of $15.9 million in estate taxes was collected and deposited in the general fund of the state treasury for fiscal year 1984. This amount was 0.3% of total state tax revenues.

PREFERENTIAL VALUATIONS

3.01 ALTERNATE VALUATION OF PROPERTY

Internal Revenue Code, Section 2032; Minnesota Statutes, Section 291. 215, Subd. 1

Definition
As a general rule, property included in a decedent's gross estate is valued at its fair market value as of the date of death. However, the decedent's personal representative may choose an alternate valuation which is the value of the property six months after death. Property which is sold, distributed, or otherwise disposed of during the six month period is valued at its fair market value at the time of disposition. When the alternate valuation is used, it must be used for all property. The tax expenditure in this provision is the difference between the tax liability using the valuation on the date of death and the tax liability using the alternate valuation.

Minnesota enacted this provision adopting I.R.C., Section 2032 in 1980; there has been no change since that time.

Fiscal Impact

FY 1984	$110,000
FY 1985	100,000
FY 1986	Minimal
FY 1987	Minimal

3.02 SPECIAL USE VALUATION

Internal Revenue Code, Section 2032 A; Minnesota Statutes, Section 291.075

Definition
Property is generally included in the estate at its fair market value. Fair market value is a property's value based on its best possible use. However, certain property which is used in a farm or other closely held business may be valued at its farm or business use value, even though this is less than the "highest and best use" value. The total decrease in the value of the property for which the special use valuation applies cannot be more than $750,000. The estimates below measure the difference between tax liability using the highest use market value and tax liability using the special use valuation.

The special use valuation option was included in Minnesota's estate tax when it was enacted in 1979. The last change occurred in 1980.

Fiscal Impact

FY 1984	$1,100,000
FY 1985	940,000
FY 1986	880,000
FY 1987	740,000

EXCLUSIONS

3.03 CHARITABLE GIFTS

Minnesota Statutes, Section 291.05 (1)

Definition
Gifts from an estate to certain persons or organizations are excluded from the Minnesota gross estate for tax purposes. Qualifying recipients include: charitable, scientific, literary, and educational organizations; public cemeteries; religious organizations; members of the clergy ($1,000 maximum); employee stock ownership trusts; and federal, state, or local governments. Gifts to non-Minnesota recipients are excludable only if the recipient's state would allow an exclusion under similar circumstances for charitable gifts to Minnesota recipients.

This provision was first enacted in 1911 and exempted from the inheritance tax gifts to charitable, religious, and educational organizations, and units of government. Scientific and literary groups were added to the list in 1919, public cemeteries in 1927, members of the clergy in 1963, and employee stock ownership trusts in 1974. In 1979 when the inheritance tax was repealed, this exemption was carried over to the estate tax. The most recent change was in 1981.

Fiscal Impact

FY 1984	$3,700,000
FY 1985	3,600,000
FY 1986	3,500,000
FY 1987	3,500,000

3.04 PENSIONS AND ANNUITIES

Minnesota Statutes, Section 291.065

Definition
Minnesota exempts from the estate tax the value of pensions and annuities which a person receives because they survive the decedent. Because the revenue impact of exempting spousal pensions and annuities is measured as a part of the marital deduction (item 3.08), that impact is not included here.

This exemption was enacted in 1959 as part of the inheritance tax. When the inheritance tax was repealed in 1979, this provision was carried over to the estate tax. The provision was last changed in 1981.

Fiscal Impact

FY 1984	$370,000
FY 1985	290,000
FY 1986	250,000
FY 1987	200,000

3.05 SOCIAL SECURITY BENEFITS

Minnesota Statutes, Section 291.05 (4)

Definition
Social security lump sum death benefits, which are paid to surviving spouses and dependents upon claim, are exempt from the Minnesota estate tax. The amount of the lump sum benefit is fixed at $255.

This exemption was enacted in 1963 under the inheritance tax laws and was carried over to the estate tax without change when the inheritance tax was repealed in 1979.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

3.06 VETERANS' BURIAL BENEFITS

Minnesota Statutes, Section 291.05(4)

Definition
Minnesota exempts from gross estate the amount of veterans' burial benefits received from the Veterans Administration (VA) by a deceased veteran's estate. This benefit is typically $300, unless a veteran dies from service-related injuries, in which case benefits may be as high as $1,100. Only veterans on a VA pension or disability plan, or veterans who die in a VA hospital, are eligible for the burial benefit.

This exemption was enacted in 1979 and has not been changed.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

3.07 PROCEEDS FROM MILITARY VETERANS' LIFE INSURANCE

Minnesota Statutes, Section 291.05(2)

Definition
Generally, the proceeds of all insurance on a decedent's life which are received by the estate, and all proceeds from life insurance in which the decedent had incidence of ownership (power to change beneficiary, able to borrow on the policy, etc.), are included in Minnesota gross estate and subject to tax. However, Minnesota exempts from estate tax the proceeds of any insurance policy issued by the United States and generally known as "war risk insurance, U.S. government life insurance, national service life insurance, or servicemen's group life insurance", which is payable upon the death of the policyholder.

This provision was originally enacted by the Legislature in 1951, under the inheritance tax. With some modification, it was carried over to the estate tax in 1979. There have been no changes since that time.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

DEDUCTIONS

3.08 MARITAL DEDUCTION

Minnesota Statutes, Section 291.051

Definition
The net value of all Minnesota property passing from a decedent to a surviving spouse may be deducted from the decedent's Minnesota gross estate. The net value of the property is the gross value reduced by the amount of exemptions and deductions associated with the property being passed to the spouse.

This deduction was enacted by the Legislature in 1911 as a $10,000 inheritance tax deduction. In 1979, when the inheritance tax was repealed, the marital deduction was continued for estate tax purposes, with a maximum deduction of $250,000 or one-half the adjusted gross estate, whichever was greater. The last change, in 1981, provided for an unlimited marital deduction.

Fiscal Impact

FY 1984	$20,000,000
FY 1985	18,000,000
FY 1986	17,000,000
FY 1987	16,000,000

CREDITS

3.09 PREVIOUSLY PAID ESTATE OR INHERITANCE TAX

Minnesota Statutes, Section 291.06

Definition
A credit against estate tax due may be claimed for property which was inherited from a person who died up to five years before the decedent. The credit is limited to the lesser of: 1) prior Minnesota estate or inheritance taxes paid on the property, if assessed within those five prior years, or 2) current Minnesota estate taxes attributable to the property, or traceable assets acquired by exchange. If there was no prior estate or inheritance tax paid, there is no current credit.

The credit may be applied only to a tax computed under the Minnesota rate schedule. If the tax paid is the federal credit amount for state death taxes, this credit may not be taken.

This credit was enacted in 1939, as part of the inheritance tax law. In 1979, when the inheritance tax was repealed, this provision was continued as part of the estate tax. The credit was last changed in 1980.

Fiscal Impact

FY 1984	$300,000
FY 1985	300,000
FY 1986	300,000
FY 1987	300,000

CHAPTER 4: GENERAL SALES AND USE TAX

INTRODUCTION

Minnesota's general sales and use tax was enacted in July of 1967 as part of the Tax Reform and Relief Act. In the first fiscal year of its existence, fiscal year 1968, the sales and use tax raised about $113 million, representing almost 8% of total state tax collections. In fiscal year 1984, net sales and use tax collections were $1.25 billion, representing 25% of total state tax revenues. All revenues from this tax go to the state general fund. (Since the sales and use tax in 1968 was imposed on motor vehicles, a true comparison between fiscal years 1968 and 1984 requires the addition of the motor vehicle excise tax collections to the 1984 sales and use tax collections. This combined amount in fiscal year 1984 totaled approximately $1.43 billion, representing almost 30% of total state tax collections. In 1972 the motor vehicle excise tax replaced the sales tax previously imposed on automobiles.)

Certainly, the importance of the Minnesota sales and use tax as a source of revenue has increased since 1968. When first enacted the sales and use tax was imposed at a rate of three percent. The rate was increased to four percent in November of 1971, to five percent in July of 1981, and to six percent in January of 1983.

In general, the sales and use tax is imposed upon the gross receipts of all persons who sell, lease or rent tangible personal property at retail or provide taxable services in Minnesota. Definitions provided in the law for several key terms may be helpful for understanding both the sales tax and its related tax expenditures. Among these terms are:

- Tangible Personal Property-Corporeal personal property of any kind whatsoever, including property which is to become a fixture or which is to lose its identity by incorporation in or attachment to real property.
- At Retail-A sale for any purpose, other than resale, in the regular course of business.
- Sales Price-The total consideration, valued in money, for a retail sale whether paid in money or otherwise, excluding: property taken in trade for resale; interest, financing, or carrying charges; charges for installation or transportation after the sale, if the charges are separately stated; certain discounts; and excise taxes imposed by the federal government.
- Sale and Purchase-Definitions of these terms in the law are used specifically to include and exclude certain items or events. As an example: food, meals or drinks served for a consideration in a nursing home or university are excluded from the definition of a sale, while other meals served for consideration, such as restaurant meals, are defined as sales. These definitions of sales and purchases in the law also result in some services being taxed. Except for the specific taxation of some services, services as a class are not commonly classified as tangible personal property and would not therefore be subject to this tax. Exempt services have been included as tax expenditures, however, for two reasons. First, some services are already taxed. Secondly, there is interest in expanding the base to include more services.

As for the mechanics of the sales and use tax, the tax is paid by the consumer, or purchaser, of the taxable item. The seller, who has received a permit from the state allowing him to make taxable retail sales, collects and remits the tax to the state with the required sales and use tax return. These returns are due either monthly, quarterly, or annually depending on the amount of taxable sales made by the vendor. Both the return and the tax are due from the vendor by the 25th of the month following the end of the assigned tax period. (The only exception to this general filing rule are returns which must be filed early due to the law requiring accelerated payment of June liability. This exception has not been addressed in the tax expenditure estimates, since the accelerated payments provision does not affect a taxpayer's annual calendar year liability.)

The tax expenditures associated with the sales and use tax have been classified into the following categories:

1. Exempt Retail Sales — Particular Goods or Services Exempt
2. Exempt Retail Sales — Sales to Particular Groups Exempt
3. Exempt Retail Sales — Sales by Particular Groups Exempt
4. Preferential Rate or Preferential Reduction in Sales Price

EXEMPTIONS — PARTICULAR GOODS AND SERVICES

4.01 FOOD

Minnesota Statutes, Sections 297A.25, Subd. 1(a) and 297A.01, Subd. 3(c)

Definition
As a general rule, all food products purchased for home consumption are exempt from the sales and use tax; and that exemption is a tax expenditure. This exemption does not include the following:

- the furnishing, preparing or serving for consideration of food, meals or drinks (see item 4.34 for those meals which are exempt)
- candy and chewing gum (except when sold for certain fundraising purposes, item 4.35)
- soft drinks
- heated food or drinks
- sandwiches prepared by the retailer
- single sales of pre-packaged ice cream or ice milk novelties prepared by the retailer
- hand-prepared or dispensed ice cream or ice milk products
- ice
- all food sold in vending machines
- party trays prepared by the retailer
- all meals, single servings of packaged snack food, and single cans or bottles of soft drinks sold in restaurants and bars.

The exemption granted sales of food was included when the sales and use tax statutes were enacted in 1967. It was last changed in 1984.

Fiscal Impact

FY 1984	$240,000,000
FY 1985	260,000,000
FY 1986	280,000,000
FY 1987	300,000,000

4.02 CLOTHING AND WEARING APPAREL

Minnesota Statutes, Section 297A.25, Subd. 1(g)

Definition
As a rule, all clothing, whether new or used, is exempt from sales and use tax. This includes inner and outer wear, footwear, headwear, gloves and mittens, neckwear, hosiery and similar items customarily worn for general use; also included are fabrics, thread, buttons, zippers and similar items which are to be directly incorporated into wearing apparel. This exemption does not apply to jewelry, articles made of fur or pelt (if the fur is more than three times the value of the next most valuable component material), perfume, luggage, handbags, billfolds, or sports clothing sold for exclusive use in a sporting activity.

The exemption granted for clothing was included in the sales and use tax statutes enacted in 1967.

Fiscal Impact

FY 1984	$120,000,000
FY 1985	130,000,000
FY 1986	140,000,000
FY 1987	150,000,000

4.03 PUBLICATIONS

Minnesota Statutes, Section 297A.25, Subd. 1(i)

Definition
Publications regularly issued at least once every three months, such as newspapers, journals, and magazines, are exempt from the sales and use tax. As of July 1, 1983, this exemption does not apply to magazines and periodicals sold over the counter (non-subscription).

The Legislature included this provision in the original sales and use tax enacted in 1967. It was last changed in 1983.

Fiscal Impact

FY 1984	$ 8,700,000
FY 1985	9,400,000
FY 1986	10,000,000
FY 1987	11,000,000

4.04 DRUGS AND MEDICINES

Minnesota Statutes, Section 297A.25, Subd. 1(b)

Definition
In general, all prescription and non-prescription drugs and medicines are exempt from the sales and use tax. Items classified as cosmetics or toiletries are not considered drugs or medicine and therefore are not exempt. A detailed list of exempt and taxable products is provided in Minnesota Rules, Part 8130.4800.

This provision was enacted in 1967.

Fiscal Impact

FY 1984	$31,000,000
FY 1985	33,000,000
FY 1986	36,000,000
FY 1987	39,000,000

4.05 PRESCRIPTION GLASSES

Minnesota Statutes, Section 297A.25, Subd. 1(b)

Definition
Sales of prescription eyeglasses, contact lenses and related items are exempt from the sales and use tax. The estimates below include the impact of the exemption for only eyeglasses and contact lenses because related items (such as eye drops and contact lens solution) are included in estimates for item 4.04 (Drugs and Medicines).

This provision was enacted in 1967.

Fiscal Impact

FY 1984	$5,100,000
FY 1985	5,600,000
FY 1986	6,300,000
FY 1987	7,100,000

4.06 THERAPEUTIC AND PROSTHETIC DEVICES

Minnesota Statutes, Section 297A.25, Subd. 1(b)

Definition
To qualify for tax exempt status, Minnesota Rules, Part 8130.4800 explains that a therapeutic device must not only be useful in the preservation of health, it must also serve to cure or heal. Therapeutic devices serve to alleviate human injury, illness, or disease, either directly or by administering a curative agent. Examples of exempt items are hypodermic syringes, oxygen tents, vaporizers, resuscitators, hospital beds, and equipment and supplies necessary for dialysis treatment.

Prosthetic devices are those which replace injured, diseased, or missing parts of the human body, either temporarily or permanently.

This provision was enacted in 1967 as part of the original sales tax statutes and remains unchanged since then.

Fiscal Impact

FY 1984	$2,700,000
FY 1985	3,000,000
FY 1986	3,300,000
FY 1987	3,700,000

4.07 FEMININE HYGIENE ITEMS

Minnesota Statutes, Section 297A.25, Subd. 1(z)

Definition
Consumer purchases of all feminine hygiene items, including sanitary napkins, tampons, and similar products, are exempt from the sales and use tax.

This exemption became effective July 1, 1981.

Fiscal Impact

FY 1984	$1,400,000
FY 1985	1,500,000
FY 1986	1,600,000
FY 1987	1,700,000

4.08 TEXTBOOKS

Minnesota Statutes, Section 297A.25, Subd. 1(u)

Definition
Sales of textbooks to students are exempt from the sales and use tax, provided that the books are required for a course of study at an educational institution. The purchaser must be regularly enrolled at a public or private college, university, business, or trade school in order to qualify under this exemption.

This provision was enacted by the Legislature in 1973.

Fiscal Impact

FY 1984	$1,100,000
FY 1985	1,300,000
FY 1986	1,400,000
FY 1987	1,600,000

4.09 MOTOR VEHICLES

Minnesota Statutes, Section 297A.25, Subd. 5

Definition
In 1971, the state enacted a motor vehicle excise tax on the sale or transfer of all vehicles required to be registered in Minnesota. At the same time, these transactions were exempted from the sales and use tax. Because the motor vehicle excise tax and the sales and use tax are very similar, this exemption is not viewed as causing revenue loss to the state and it is not considered a tax expenditure. For a more thorough discussion of the motor vehicle excise tax, see that chapter of this study.

Fiscal Impact
None

4.10 RACE HORSES

Minnesota Statutes, Section 297A.01, Subd. 3(h)

Definition
Sales of Minnesota born and bred race horses are exempt from the sales and use tax. The exemption also extends to certain fees associated with sales, such as claiming fees and breeding fees.

Sales of Minnesota race horses became exempt from the sales and use tax on April 1, 1984, approximately six months after voters had ratified an amendment to the Minnesota Constitution which made pari-mutuel betting on horse races legal in this state.

Fiscal Impact	
FY 1984	Minimal
FY 1985	Minimal
FY 1986	$110,000
FY 1987	240,000

4.11 CASKETS AND BURIAL VAULTS

Minnesota Statutes, Section 297A.25, Subd. 1(q)

Definition
The sale of caskets, burial vaults and urns used for human burial or cremation purposes are exempt from the Minnesota sales and use tax.

Since first enacted in 1967, this provision has not been changed.

Fiscal Impact	
FY 1984	$2,000,000
FY 1985	2,000,000
FY 1986	2,100,000
FY 1987	2,200,000

4.12 ACCESSORY TOOLS

Minnesota Statutes, Section 297A.25, Subd. 1(h)

Definition
As a general rule, machinery, equipment, tools, and implements used in industrial production are subject to the Minnesota sales and use tax.

This statutory provision modifies the general rule to exempt accessory tools, equipment, and other short-lived items which:

1. are separate units detachable from machinery; and
2. are used to produce a direct effect on a product; and
3. have an ordinary useful life of less than 12 months.

The estimates below reflect only those items which meet all three criteria and which are therefore exempt. Typical exempt items would be: drill bits, grinding and abrasive wheels, saw blades, printing plates, dies, jigs, taps, patterns, and molds.

The exemption for accessory tools was enacted in 1973.

Fiscal Impact

FY 1984	$13,000,000
FY 1985	14,000,000
FY 1986	15,000,000
FY 1987	16,000,000

4.13 PERSONAL PROPERTY BROUGHT INTO MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 3

Definition
When individuals, businesses, or corporations move into Minnesota to take up residency, all articles of tangible personal property they bring with them are exempt from the Minnesota use tax. Unless the Minnesota sales tax had previously been levied on them, these items would normally be subject to the use tax when brought into the state. The estimates below measure the impact of not applying the use tax. The estimates are reduced by the amount of credit which would otherwise be provided by Minnesota for sales tax paid to other states (the credit is explained in item 4.41).

This provision was enacted in 1967 and remains unchanged since then.

Fiscal Impact

FY 1984	$3,800,000
FY 1985	3,900,000
FY 1986	4,000,000
FY 1987	4,200,000

4.14 PACKING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 1(e)

Definition
This provision exempts all sales to moving or transfer companies of packing materials used to pack and ship household goods. The packing materials must be used to ship goods to an out-of-state destination and must not be returned to Minnesota except as to pass through the state in the course of interstate commerce.

This exemption became effective in 1973 and has not been amended or revised since that time.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

4.15 LEASES OF DRIVE-IT-YOURSELF AUTOMOBILES

Minnesota Rules, Part 8130.0400, Subp. 2

Definition
The use tax applies generally to the use of property in this state. However, when a person leases a drive-it-yourself automobile from a rental agency located in another state, and returns it to and pays for it at an agency located inside Minnesota, no Minnesota sales or use tax is imposed on the transaction. This is true no matter what portion of the rental payments are for miles driven within Minnesota.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

4.16 GOODS SHIPPED OR TRANSPORTED OUT OF STATE

Minnesota Statutes, Section 297A.25, Subd. 1(d)

Definition
Goods sold to out-of-state purchasers for use outside the state in a trade or business are treated preferentially in one of two ways:

1. When an out-of-state purchaser comes to Minnesota to both buy and pick up the goods, a Minnesota sales tax is applied at a rate equal to the use tax imposed by the state where the goods will be taken and used. Because of Minnesota's relatively high sales tax rate, this generally results in a reduced rate being applied to these sales. (If the other state applies no use tax to the goods, the sale is subject to the full Minnesota tax rate and no preferential treatment occurs.)
2. When the seller ships the goods to the out-of-state buyer, whether through the U.S. mail, parcel post, common carrier, or by means of the seller's own delivery vehicles, the goods are exempt from the sales and use tax.

This estimate includes only those of type (1), above. The fiscal impact measures the difference between the current reduced rates allowed, and what would be the case if all such sales were subject to the full Minnesota tax rate. Type (2) transactions were not included in the estimates because it is doubtful the state could tax them due to federal restrictions on a state's power to tax interstate commerce.

This provision was enacted in 1967 as a broad exemption for all goods purchased for use out of state. In 1982, the Legislature limited the scope of this provision to the two types of transactions listed above.

Fiscal Impact

FY 1984	$230,000
FY 1985	250,000
FY 1986	260,000
FY 1987	270,000

4.17 RESOURCE RECOVERY EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 1(aa)

Definition
Beginning July 1, 1984, purchases of equipment used to process solid or hazardous waste at a resource recovery facility are exempt from the sales and use tax. Three types of solid waste processing equipment qualify: those used for incineration, recycling, and composting. Currently, no hazardous waste processing facilities are located or under construction in Minnesota. As a result, the estimates below include only the exemption granted to solid waste processing equipment.

This provision was enacted by the Legislature in 1984, along with an income tax credit equal to a portion of the purchase cost (see items 1.83 and 2.31).

Fiscal Impact

FY 1984	None
FY 1985	$300,000
FY 1986	300,000
FY 1987	300,000

4.18 CLUB DUES

Minnesota Rules, Part 8130.0900, Subp. 5

Definition
Generally taxable under the Minnesota sales and use tax are the sales of admissions to amusements and athletic events, and the use of amusement devices. This would include those portions of club or other membership dues which specifically entitle the payor to attend concerts or similar events. This tax expenditure provision grants an exemption for membership dues paid to country clubs, curling clubs, tennis clubs, and other similar clubs where, although there is no entitlement to attend a specific event, a portion of the dues payments may represent fees for the use of or admission to an athletic or amusement facility.

Fiscal Impact

FY 1984	$5,000,000
FY 1985	5,500,000
FY 1986	6,000,000
FY 1987	6,600,000

4.19 ADMISSION FEES TO RECREATIONAL AREAS

Minnesota Rules, Part 8130.0900, Subp. 8

Definition
Although an admission charge to any place of amusement is taxable, recreational areas which provide no facilities other than parking lots, fire pits, docks, tables, and equipment necessary for the preservation of the area are not considered amusement areas. Admission charges to certain campgrounds and other recreational areas are therefore exempt from the sales and use tax.

Fiscal Impact

FY 1984	$480,000
FY 1985	520,000
FY 1986	580,000
FY 1987	650,000

4.20 ADMISSION TO ARTISTIC PERFORMANCES

Minnesota Statutes, Section 297A.25, Subd. 1(x)

Definition
In general, an admission charge is a taxable sale. Taxable admission charges include those for concerts, stage plays, and dances, among others. This provision exempts from taxation the sale of tickets or admissions to events which provide opportunities for participation "in the creation, performance or appreciation of the arts." Only those artistic events sponsored by organizations which are exempt from income taxes, for example churches and charities, qualify under this provision.

This exemption was enacted in 1980 and remains unchanged since then.

Fiscal Impact

FY 1984	$2,000,000
FY 1985	2,100,000
FY 1986	2,200,000
FY 1987	2,300,000

4.21 MEALS GIVEN TO EMPLOYEES

Minnesota Rules, Part 8130.0800, Subp. 7

Definition
Meals provided by employers to employees are generally taxable if the employee pays for the meal, but they are not considered to be taxable if the meal is provided at no cost to the employee. This exemption is considered a tax expenditure because the transaction could be taxed if an imputed cost or price value were used. This provision is not limited to employers in the restaurant or food service business.

Fiscal Impact

FY 1984	$1,800,000
FY 1985	1,900,000
FY 1986	2,000,000
FY 1987	2,100,000

4.22 SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3 and 4

Definition
Services deserve special attention because they are conceptually different from other tax expenditures in the sales tax area. The Minnesota sales tax is imposed on all retail sales of "tangible personal property" within the state. This language would seem to indicate that services should not only be excluded from the tax, but from this study as well. When a group of taxpayers (or a type of transaction) is outside a tax base, and not merely exempt from tax by a special provision, generally no tax expenditure exists. However, while services in general do not fall within the defined tax base, certain services are taxed. For example, the sale of services associated with providing prepared food or lodging are currently taxed. It is because of these and other examples of services being subject to the sales and use tax, as well as the recent interest in adding more services to the tax base, that this item has been included in the study.

It should be noted that the exemption of some services, such as the providing of sewer, water, or long-distance telephone service, are dealt with as separate tax expenditures because they are dealt with separately in the law. The total fiscal impact for this item includes only those services found in the list below.

Although there is no statutory provision which specifically excludes services from the sales and use tax, services as a class have not been subject to taxation since the sales tax was imposed in 1967.

Fiscal Impact

FY 1984	$360,000,000
FY 1985	390,000,000
FY 1986	434,000,000
FY 1987	482,000,000

The following is a breakdown of services into eleven categories based on the Standard Industrial Classification (SIC). The totals above and the various subtotals below may not exactly add up due to rounding. It should also be noted that all estimates have been adjusted so they do not include services which would remain exempt from tax, even if services in general were subject to the sales and use tax. Services provided to the federal government or to nonprofit organizations are examples of services which would remain exempt due to other provisions of the law.

Also, the estimates have been adjusted to exclude currently taxable portions of service industry receipts, as for example, when the service portion of a transaction is not, or cannot, be separated from the sale of a tangible product.

	(All Figures in Thousands)			
	FY 84	FY 85	FY 86	FY87
A. Personal Service (total)	**$28,000**	**$ 30,000**	**$ 33,000**	**$ 36,000**
1. Laundry, Cleaning and Garment Service	8,700	9,400	10,200	11,100
2. Beauty Shops	8,900	9,700	10,500	11,500
3. Barber Shops	1,400	1,500	1,700	1,800
4. Shoe Repair	280	300	330	350
5. Funeral Services and Crematories	4,000	4,400	4,800	5,200
6. Miscellaneous Personal Services	4,500	4,900	5,300	5,800
B. Legal Services (total)	**$37,000**	**$ 41,000**	**$ 45,000**	**$ 51,000**
C. Engineering, Architectural, and Surveying Services (total)	**$27,000**	**$ 29,000**	**$ 32,000**	**$ 36,000**
D. Business Services (total)	**$75,000**	**$ 83,000**	**$ 93,000**	**$105,000**
1. Advertising	9,400	10,500	11,700	13,200
2. Consumer Credit Reporting and Other Agencies	1,900	2,100	2,400	2,700
3. Mailing, Reproduction, Commercial Art and Stenographic Services	3,000	3,300	3,700	4,200

	FY 84	FY 85	FY 86	FY87
	(All Figures in Thousands)			
4. Services to Dwellings and Other Buildings	5,000	5,500	6,200	7,000
5. Personnel Supply Services	9,700	10,800	12,000	13,600
6. Computer and Data Processing	17,000	19,000	21,000	23,000
7. Miscellaneous Business Services	29,000	32,000	36,000	41,000
E. Accounting (total)	**$15,000**	**$ 16,000**	**$ 18,000**	**$ 19,000**
F. Auto Services (total)	**$16,000**	**$ 18,000**	**$ 20,000**	**$ 22,000**
1. Parking Lots and Structures	2,200	2,400	2,700	3,000
2. Automotive Repair Services	12,000	13,000	15,000	16,000
3. Automotive Services Other Than Repair	2,000	2,200	2,500	2,700
G. Miscellaneous Repair Services (total)	**$ 6,000**	**$ 6,600**	**$ 7,100**	**$ 7,700**
1. Electrical and Electronic Repair	1,000	1,100	1,200	1,300
2. Watch, Clock, and Jewelry Repair	79	87	94	102
3. Reupholstery and Furniture Repair	75	82	88	96
4. Other Miscellaneous Repair Services	4,900	5,400	5,800	6,300
H. Health Services (total)	**$98,000**	**$107,000**	**$117,000**	**$129,000**
1. Physicians	53,000	58,000	63,000	70,000
2. Optometrists	1,700	1,800	2,000	2,100
3. Dentists	17,000	18,000	20,000	22,000
4. Osteopathic Physicians	1,500	1,600	1,800	2,000
5. Other Health Practitioners	1,500	1,600	1,800	1,900
6. Nursing and Personal Care Facilities	11,000	12,000	13,000	15,000
7. Medical and Dental Laboratories	2,500	2,700	2,900	3,200
8. Health and Allied Services Not Classified Elsewhere	7,600	8,300	9,000	10,000
9. Veterinarians	2,100	2,200	2,300	2,400
I. Educational Services (total)	**$23,000**	**$ 25,000**	**$ 27,000**	**$ 30,000**
1. Elementary and Secondary Schools	4,700	5,000	5,300	5,900
2. Colleges, Universities, Professional Schools, and Junior Colleges	15,000	17,000	18,000	20,000
3. Libraries and Information Services	380	400	430	480
4. Vocational and Correspondence Schools	1,800	1,800	2,000	2,200
5. Schools and Educational Services Not Classified Elsewhere	1,200	1,300	1,400	1,500
J. Social Services (total)	**$27,000**	**$ 29,000**	**$ 32,000**	**$ 36,000**
1. Child Day Care Services	3,500	3,800	4,200	4,600
2. Individual and Family, Job Training and Rehabilitation, Residential Care, and Social Services not Classified Elsewhere	23,000	26,000	28,000	31,000
K. Transportation (total)	**$ 8,800**	**$ 9,500**	**$ 10,200**	**$ 10,800**
1. Taxi Services	3,100	3,300	3,700	4,000
2. Intercity Bus Services	2,300	2,400	2,600	2,800
3. Other Local Transit Services	3,500	3,700	3,900	3,900

4.23 RESIDENTIAL SEWER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3(f)

Definition
The furnishing of sewer services to residential customers is specifically exempt from the Minnesota sales and use tax.

This provision was enacted in 1967 and has remained unchanged.

Fiscal Impact

FY 1984	$5,500,000
FY 1985	5,800,000
FY 1986	6,100,000
FY 1987	6,400,000

4.24 RESIDENTIAL WATER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3(f)

Definition
The furnishing of water services to residential customers is specifically exempt from the Minnesota sales and use tax.

This provision was enacted in 1979 and has remained unchanged.

Fiscal Impact

FY 1984	$5,800,000
FY 1985	6,300,000
FY 1986	7,000,000
FY 1987	7,700,000

4.25 RESIDENTIAL HEATING FUELS

Minnesota Statutes, Section 297A.25, Subd. 1(w)

Definition
Generally, sales of electricity, gas, water, steam, or other energies for use or consumption within Minnesota are taxable. This provision, however, exempts from the sales and use tax any fuel oil, coal, wood, steam, propane or L.P. gas sold for residential use. Additionally, purchases of natural gas or electricity by customers who use natural gas or electricity for their primary source of residential heat are exempt from November 1 through April 30.

This provision was enacted in 1978 and expanded in 1984 to include hot water heat sold for residential use.

Fiscal Impact

FY 1984	$61,000,000
FY 1985	63,000,000
FY 1986	65,000,000
FY 1987	68,000,000

4.26 INTERSTATE TELEPHONE SERVICE

Minnesota Rules, Part 8130.1100

Definition
While Minnesota subjects local exchange telephone service, and service for toll calls made entirely within Minnesota, to the sales and use tax, long-distance calls made to points outside the state are entirely exempt from the tax. Because the Interstate Commerce Commission has ruled that long-distance calls do not constitute interstate commerce, apparently the state could tax all phone service under the sales and use tax, if it chose to do so.

Fiscal Impact

FY 1984	$18,000,000
FY 1985	21,000,000
FY 1986	24,000,000
FY 1987	27,000,000

EXEMPTIONS — SALES TO PARTICULAR GROUPS

4.27 SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Section 297A.25, Subd. 1(j)

Definition
The sale of tangible personal property to the United States or to a state, or their agencies, instrumentalities, or political subdivisions, is exempt from the Minnesota sales and use tax. This represents a tax expenditure to the extent that the exemption costs the state money and to the extent that the state could tax the transaction if it chose to do so. The estimates below measure only the fiscal impact of exempting Minnesota's local and regional governments. Also, it should be noted that these estimates do not include items such as food, clothing and motor vehicles, which would remain exempt due to other provisions even if local government purchases were generally subject to taxation.

This exemption was enacted in 1967 and last revised in 1983.

Fiscal Impact

FY 1984	$37,000,000
FY 1985	41,000,000
FY 1986	45,000,000
FY 1987	49,000,000

4.28 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 1(p); Minnesota Rules, Part 8130.6200

Definition
According to Minnesota Statutes, Section 297A.25, Subd. 1(p), ". . .the sale of tangible personal property to, and storage, use, or other consumption of such property by, any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious, or educational purposes . . ." is exempt from the sales and use tax. The property purchased must be used in the performance of the charitable, religious, or educational function of the tax-exempt organization. In general, organizations qualifying for this exemption are the same as those discussed in item 2.01 (organizations listed in subchapter F), but there are several differences. Political organizations, fraternal or beneficial societies, and most clubs

organized and operated for pleasure, recreation or other similar purposes are examples of nonprofit organizations which are not exempt from the sales tax.

It should be noted that the estimates below do not include: sales to governments, which are discussed in item 4.27; sales to veterans organizations, discussed in item 4.29; or sales of items such as food and services which are exempt due to other provisions of this tax.

This provision was included in the sales and use tax when it was enacted in 1967. In 1979 the definition of nonprofit organizations was broadened to include senior citizens' groups operated for nonprofit purposes. The most recent change was in 1983.

Fiscal Impact

FY 1984	$17,000,000
FY 1985	18,000,000
FY 1986	19,000,000
FY 1987	21,000,000

4.29 SALES TO VETERANS' ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 1(y)

Definition
Purchases of tangible personal property and the storage, use, or consumption of such property by an organization of military service veterans, or its auxiliary unit, are exempt from taxation provided:

1. The group is organized in Minnesota and is exempt from income taxes under federal law; and
2. The property is used for charitable, civic, educational or nonprofit uses, and not for social, recreational, pleasure or profit uses.

The exemption does not apply to sales made by veterans organizations. Sales of otherwise taxable items by these groups are subject to the sales tax.

This provision was enacted by the Legislature in 1980.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

4.30 SALES OF BUILDING MATERIALS TO DISABLED VETERANS

Minnesota Statutes, Section 297A.25, Subd. 1(t)

Definition
Building materials used in constructing or remodeling a disabled veteran's residence are exempt from the sales and use tax, provided the project was financed in whole or in part by the U.S. Government in accordance with Title 38, United States Code, Sections 801 to 805. This exemption is provided in the form of a refund to the veteran for sales tax paid.

The Legislature enacted this exemption in 1971.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

4.31 CONSTRUCTION MATERIALS OR EQUIPMENT (ENTERPRISE ZONES)

Minnesota Statutes, Section 273.1314, Subd. 9(a)(1)

Definition
An exemption from the sales and use tax may be authorized for sales of construction materials or equipment used in a designated enterprise zone. Only those sales made after an approved application for the enterprise zone was made may qualify for the exemption.

This provision was enacted in 1983 and was last changed in 1984. This exemption, along with the enterprise zone program, is scheduled to expire on December 31, 1996.

Fiscal Impact

FY 1984	$ 110,000
FY 1985	1,000,000
FY 1986	900,000
FY 1987	900,000

4.32 NEW SATELLITE BROADCASTING FACILITY

Minnesota Statutes, Section 297A.253

Definition
All materials, supplies, and equipment used or consumed in the construction and equipping of a new, FCC licensed, direct satellite broadcasting facility within Minnesota are exempt from the sales and use tax.

This exemption was enacted by the Legislature in 1983.

Fiscal Impact

FY 1984	None
FY 1985	$300,000
FY 1986	600,000
FY 1987	300,000

EXEMPTIONS — SALES BY PARTICULAR GROUPS

4.33 ISOLATED OR OCCASIONAL SALES

Minnesota Statutes, Section 297A.25, Subd. 1(k)

Definition
Although all sales of tangible personal property in Minnesota are generally subject to the sales and use tax, isolated or occasional sales made by persons not engaged in selling such property in the normal course of business are exempt. The following singular or infrequent sales are examples of those qualifying for exemption:

- The sale of a used lawn mower to a neighbor;
- Sales made by a fiduciary in the liquidation of an estate;
- The sale of an entire business by the owner (except that the transfer of stock or inventory is taxable);
- Garage sales, where the items sold have not been specifically gathered for resale;
- Sales by nonprofit organizations at bazaars, picnics, rummage sales, etc.; and
- Occasional meals served by charitable or religious organizations.

This provision was enacted by the Legislature in 1967 and last revised in 1983.

Fiscal Impact

FY 1984	$10,000,000
FY 1985	10,000,000
FY 1986	11,000,000
FY 1987	12,000,000

4.34 INSTITUTIONAL MEALS

Minnesota Statutes, Section 297A.01, Subd. 3(c)

Definition
As a rule, prepared meals offered for sale are subject to the sales and use tax. This provision exempts from tax meals and drinks furnished, prepared, or served by hospitals, nursing homes, sanitariums, and senior citizens' homes; and, meals and drinks served at public and private schools, universities, and colleges.

This provision was enacted as part of the sales and use tax law in 1967 and was last changed in 1975 when it was expanded to include congregate dining, the home delivery of meals, and other programs which provide meals to senior citizens or the handicapped.

Fiscal Impact

FY 1984	$11,000,000
FY 1985	12,000,000
FY 1986	13,000,000
FY 1987	14,000,000

4.35 CANDY SALES BY ORGANIZATIONS WHICH PROVIDE SERVICES TO MINORS

Minnesota Statutes, Section 297A.25, Subd. 1(a) (i)

Definition
Candy and candy products are exempt from tax when sold for fund raising purposes by a nonprofit organization which provides educational and social activities for young people aged eighteen and under. Candy sold by the Camp Fire Girls is an example of sales which are exempt due to this provision.

This exemption was enacted in 1984 and became effective for sales made after June 30, 1984.

Fiscal Impact

FY 1984	None
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

SPECIAL RATES/REDUCED SALES PRICE

4.36 FOUR PERCENT RATE FOR FARM MACHINERY

Minnesota Statutes, Section 297A.02, Subd. 2, and 297A.14

Definition
The sales and use tax is applied to new or used farm machinery at a special four percent rate. According to Minnesota Statutes, Section 297A.01, Subd. 15, farm machinery includes "machinery, equipment, implements, accessories and contrivances used directly and principally in the production for sale" of farm products. The term "farm machinery" does not include machinery used in the post-production processing of farm produce or livestock, machinery used primarily for garden or yardwork, or replacement parts.

The special rate for farm machinery was enacted by the Legislature in 1981 when the general sales and use tax rate was raised from four percent to five percent. When the general rate was raised to six percent in 1983, farm machinery continued to be subject to the four percent rate.

Fiscal Impact

FY 1984	$12,000,000
FY 1985	12,000,000
FY 1986	13,000,000
FY 1987	13,000,000

4.37 FOUR PERCENT RATE FOR LOGGING EQUIPMENT

Minnesota Statutes, Section 297A.01, Subd. 15 and 297A.02, Subd. 2

Definition
All new and used logging equipment, other than chain saws, is subject to a four percent sales and use tax rate, rather than the general six percent rate.

Enacted in 1984, the reduced rate for logging equipment became effective for sales made after June 30, 1984.

Fiscal Impact

FY 1984	None
FY 1985	$260,000
FY 1986	280,000
FY 1987	300,000

4.38 FOUR PERCENT RATE FOR CAPITAL EQUIPMENT SOLD TO NEW OR EXPANDING INDUSTRIES

Minnesota Statutes, Section 297A.01, Subd. 16; 297A.02, Subd. 2; and 297A.15, Subd. 5

Definition
Certain capital equipment and machinery purchases are subject to a four percent sales and use tax rate, rather than the general six percent rate. In order to qualify, the capital equipment, or the materials necessary to construct and install it, must be used by the purchaser or lessee to establish or expand a manufacturing, fabricating, or refining facility in the state. This reduced rate does not extend to: 1) equipment purchased as replacements; 2) replacement or repair parts; or 3) machinery or equipment used to extract, receive, or store raw materials.

This provision was enacted in 1984.

Fiscal Impact

FY 1984	None
FY 1985	$ 5,400,000
FY 1986	10,000,000
FY 1987	12,000,000

4.39 FOUR PERCENT RATE FOR SPECIAL TOOLING

Minnesota Statutes, Section 297A.01, Subd. 17 and 297A.02, Subd. 2

Definition
Special tools, defined as "tools, dies, jigs, patterns, gauges, and other special tools which have value and use only for the buyer and for the use for which it is made", are subject to a four percent sales and use tax rate, rather than the general six percent rate. To qualify for the reduced rate, items generally must be special ordered and produced in accordance with buyer specifications. Some special tools are also classified as "accessory tools," in which case they are exempt from any sales tax. Accessory tools are discussed in item 4.12. The estimates below show the impact for only that special tooling which is subject to the four percent rate.

The reduced rate for special tooling was enacted in 1984.

Fiscal Impact

FY 1984	None
FY 1985	$170,000
FY 1986	180,000
FY 1987	190,000

4.40 TAXES IMPOSED BY THE U.S. GOVERNMENT

Minnesota Rules, Part 8130.1700, Subp. 7

Definition
When computing the Minnesota sales and use tax, the retail sales price of a good is reduced by certain federal taxes imposed upon the consumer or retailer. The federal excise tax on communications (telephone and teletype) and all custom duties levied on goods brought into Minnesota are excluded from the taxable sales price under this provision. Part of the reason this provision is considered a tax expenditure is that several taxes are included in the Minnesota taxable sales price of goods, including the federal excise taxes on alcohol, tobacco, manufacturers, and importers.

Fiscal Impact

FY 1984	$6,100,000
FY 1985	6,700,000
FY 1986	7,500,000
FY 1987	8,500,000

4.41 TAX PAID TO OTHER STATES

Minnesota Statutes, Section 297A.24

Definition

Taxpayers are subject to a reduced tax rate if they have previously paid sales, use, or consumption taxes to another state on any taxable personal property sold or used in Minnesota. In practice, the reduced rate is the equivalent of providing a credit to taxpayers for taxes paid to other states. If the other state's rate is lower than the applicable Minnesota rate, then the Minnesota rate becomes the difference between the two rates. If the other state's rate is equal to or higher than Minnesota's rate, no Minnesota sales and use tax is imposed.

The estimates below are based on actual use tax returns filed. No attempt was made to estimate those cases technically subject to the reduced rate for which no Minnesota use tax return is filed.

This provision was enacted in 1967 as part of the original sales and use tax law.

Fiscal Impact

FY 1984	$400,000
FY 1985	400,000
FY 1986	400,000
FY 1987	400,000

CHAPTER 5: MOTOR VEHICLE EXCISE TAX

INTRODUCTION

The motor vehicle excise tax was enacted in 1971 at a three percent rate as a substitute for the general sales and use tax imposed on the sale of motor vehicles. Prior to 1971, sales of motor vehicles were taxed under the general sales and use tax. Upon enactment of this tax they were exempted from taxation under the sales tax.

The base for this tax is the purchase price of a motor vehicle when ownership is transferred. In the case of a gift or other transfer for nominal consideration, the statute defines the purchase price as the average value of a similar motor vehicle.

The tax is imposed on motor vehicles, no matter where purchased, at the time the vehicle is registered in Minnesota. If ownership is transferred, no registration plates or certificates will be issued until the motor vehicle excise tax is paid.

Currently the tax rate is six percent. The rate is defined in the statutes to be the same as the general sales and use tax rate. Unlike the sales tax, the motor vehicle excise tax is imposed on occasional or isolated private party transfers.

In fiscal year 1984, collections from this tax amounted to $179.0 million, or 3.6% of total state tax revenues. The distribution of the revenues from this tax for fiscal years 1985 through 1987 will be 18.75% to the highway user tax distribution fund of the state treasury, 6.25% to the transit assistance fund of the state treasury, and the balance to the general fund of the state. In fiscal year 1984, the revenue from this tax was credited entirely to the general fund of the state treasury.

EXEMPTIONS

5.01 VEHICLES ACQUIRED BY INHERITANCE

Minnesota Statutes, Section 297B.01, Subd. 7(a)

Definition
When any vehicle is transferred by inheritance or bequest of a decedent, that transfer is exempt from the motor vehicle excise tax.

The Legislature enacted this provision in 1971.

Fiscal Impact

FY 1984	$2,300,000
FY 1985	2,400,000
FY 1986	2,500,000
FY 1987	2,500,000

5.02 OUT-OF-STATE ACQUISITIONS

Minnesota Statutes, Section 297B.03 (2)

Definition
When a person moves to Minnesota and establishes residency here, all motor vehicles owned by that person which were purchased and titled in another state more than 60 days prior to the move are exempt from the Minnesota motor vehicle excise tax.

This provision was enacted in 1971 and remains substantially unchanged since that time.

Fiscal Impact

FY 1984	$670,000
FY 1985	700,000
FY 1986	730,000
FY 1987	770,000

5.03 TRANSFERS BETWEEN JOINT OWNERS

Minnesota Statutes, Section 297B.01, Subd. 7 (b)

Definition
When the joint owner of a motor vehicle gratuitously transfers his or her interest to the other joint owner(s) of the vehicle, the transaction is exempt from the motor vehicle excise tax.

Enacted in 1971, this provision remains unchanged.

Fiscal Impact

FY 1984	$460,000
FY 1985	480,000
FY 1986	500,000
FY 1987	520,000

5.04 TRANSFERS BETWEEN SPOUSES, PARENTS AND CHILDREN, AND GUARDIANS AND WARDS

Minnesota Statutes, Section 297B.01, Subd. 7(c) and 8

Definition
Any transfer of a vehicle in the form of a gift (where no monetary consideration is involved) between spouses, a parent and a child, or a guardian and a ward, is exempt from the motor vehicle excise tax. Since other transfers of vehicles by gift are taxed on the basis of the fair market value of the vehicle, this provision is a tax expenditure.

This exemption was enacted by the Legislature in 1971. It was last changed in 1974.

Fiscal Impact

FY 1984	$9,300,000
FY 1985	9,700,000
FY 1986	10,100,000
FY 1987	10,600,000

5.05 TRANSFERS IN DIVORCE PROCEEDINGS

Minnesota Statutes, Section 297B.01, Subd. 7(d)

Definition
The transfer of a motor vehicle between husband and wife in a divorce proceeding, whether the transfer is voluntary or involuntary, is exempt from taxation. Because transfers between joint owners are exempt under another provision (see item 5.03), the estimates below include only those transfers involving vehicles previously registered to only one person.

This provision was enacted in 1974.

Fiscal Impact

FY 1984	$200,000
FY 1985	210,000
FY 1986	230,000
FY 1987	250,000

5.06 CORPORATE AND PARTNERSHIP TRANSFERS

Minnesota Statutes, Section 297B.03 (4)

Definition
When an individual transfers a vehicle to a corporation in exchange for stock or securities, or to a partnership in exchange for an interest in the partnership, the transfer is exempt from the motor vehicle excise tax.

Enacted by the Legislature in 1975, this provision has never been amended.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

5.07 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297B.03 (1)

Definition
The simple purchase or acquisition of motor vehicles by a qualified charitable, religious, or educational organization has historically been exempt from the motor vehicle excise tax. In 1982, the Legislature broadened the scope of this provision to also exempt vehicles purchased or acquired through third party lease-purchase agreements and installment-sale contracts entered into by these entities.

This exemption has been allowed since the motor vehicle excise tax was enacted in 1971. It was last amended in 1982.

Fiscal Impact

FY 1984	$620,000
FY 1985	650,000
FY 1986	680,000
FY 1987	710,000

5.08 SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Section 297B.03 (1)

Definition
All motor vehicles purchased by the U.S. government, state governments, their agencies, instrumentalities, or political subdivisions are exempt from the Minnesota motor vehicle excise tax. Because the state is restricted from imposing taxes on the federal government, and because tax-exempt sales to Minnesota state agencies do not represent a net revenue loss to the state, their exemption from tax is not deemed a tax expenditure. The estimates below therefore measure only the impact of exempting vehicles purchased by all local governments, and states other than Minnesota. This provision exempts automobiles, buses, road maintenance equipment and public safety vehicles.

This provision was enacted in 1971 and last changed in 1982.

Fiscal Impact

FY 1984	$1,000,000
FY 1985	1,000,000
FY 1986	1,200,000
FY 1987	1,300,000

5.09 SALES TO DISABLED VETERANS

Minnesota Statutes, Section 297B.03 (1)

Definition
Disabled veterans who purchase motor vehicles with funds provided, either in whole or in part, by the Veterans Administration, under the provisions of Title 38, U.S.C., Section 1901, are not required to pay any motor vehicle excise tax.

This provision was enacted by the Legislature in 1971 and has not been revised since that time.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

5.10 MOTOR CARRIER LEASING

Minnesota Statutes, Section 297B.03 (5)

Definition
Vehicles owned by a resident of another state, which are leased to a Minnesota motor carrier for use in interstate commerce, are exempt from the motor vehicle excise tax, provided that the vehicle is titled in the other state and that the other state does not impose a sales or excise tax on motor vehicles used in interstate commerce. Wisconsin, for instance, is a state which does not levy a tax on motor vehicles used in interstate commerce under the reciprocal provisions referred to above.

This exemption was enacted by the Legislature in 1984.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

5.11 FEDERAL EXCISE TAXES

Minnesota Statutes, Section 297B.01, Subd. 8

Definition
When computing the Minnesota motor vehicle excise tax, any federal taxes imposed on the retail sale of a vehicle may be eliminated from the purchase price. At the present time two federal excise taxes are levied upon new motor vehicles (both at a rate of 12% of retail price): the first is levied upon trucks in excess of 33,000 lbs. gross vehicle weight; and, the second is levied upon trailers or semitrailers in excess of 26,000 lbs. gross vehicle weight.

This provision was enacted in 1983.

Fiscal Impact

FY 1984	$240,000
FY 1985	260,000
FY 1986	280,000
FY 1987	300,000

CREDITS

5.12 CREDIT FOR TAXES PAID TO OTHER STATES

Minnesota Statutes, Section 297B.08

Definition
Minnesota allows a credit against excise tax due at the time of vehicle registration for any sales, use, or excise tax paid on a vehicle to another state. However, the credit is limited in that it may be claimed only if the other state has a similar provision allowing a credit for excise taxes paid in Minnesota. This credit applies to Minnesota taxpayers in the following two circumstances:

1. When a nonresident purchases a vehicle and subsequently moves to Minnesota within 60 days of the purchase date. (See item 5.02 for a related discussion.)
2. When a Minnesota resident purchases a vehicle in another state and is subject to a sales or use tax in the state of purchase.

This exemption was enacted in 1971 and remains unchanged.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 6: MOTOR FUELS EXCISE TAXES

INTRODUCTION

A motor fuels excise tax was first imposed on the sale of gasoline in 1925, at a rate of two cents per gallon. Current rates, effective January 1, 1984, are based on the intended use or deposition of the fuel and they can be divided into four groups:

Fuel	Tax Rate Per Gallon
Highway Gasoline	17¢
Highway Special Fuel	17¢
Aviation Gasoline	5¢
Aviation Special Fuel	5¢

Special fuels were first distinguished in the statutes in 1957. Prior to that time, all motor fuels were treated alike. Special fuels are now defined as "all combustible gases and liquid petroleum products" (including petroleum substitutes), other than gasoline.

Although all of the motor fuels excise taxes are similar in most respects, there is one important difference for tax expenditure purposes. Specifically, the tax base for the highway gasoline excise tax is different from the tax base for the other three motor fuels excise taxes. The impact of this difference is that refunds of taxes paid on highway gasoline or highway special fuels used in another state is a tax expenditure only in regard to special fuels (item 6.03). For similar reasons, refunds of taxes paid on highway gasoline used "off-the-road" do not appear as tax expenditures.

Collections of highway gasoline and special fuels excise taxes were $330.3 million in fiscal year 1984. Aviation gasoline and special fuels excise tax collections in that year were $1.8 million. The combined fiscal year 1984 collections of $332.1 million represented 6.6% of total state tax collections. Revenues from the excise taxes on aviation motor fuels are credited to the state airports fund. Revenues from the excise taxes on other motor fuels are credited 99.25% to the highway users fund of the state treasury and 0.75% to the Minnesota Department of Natural Resources for various purposes.

Petroleum products which are subject to the motor fuels excise taxes are not subject to the general sales and use tax (see Appendix).

EXEMPTIONS

6.01 CITY-OWNED TRANSIT SYSTEMS

Minnesota Statutes, Sections 296.02, Subd. 1a and 296.025, Subd. 1a

Definition
Gasoline and special fuels purchased by municipally-owned transit systems are exempt from the motor fuels excise taxes.

This exemption was enacted in 1977 and has not been changed since that time.

Fiscal Impact

	Gasoline	Special Fuels	Total
FY 1984	$ 89,000	$1,700,000	$1,789,000
FY 1985	90,000	1,700,000	1,790,000
FY 1986	91,000	1,700,000	1,791,000
FY 1987	92,000	1,700,000	1,792,000

6.02 RECIPROCAL AGREEMENTS FOR OUT-OF-STATE PURCHASES

Minnesota Statutes, Section 296.17, Subd. 6

Definition
Generally, all gasoline and special fuels used or consumed on Minnesota highways, including fuels purchased in other states, are subject to the Minnesota motor fuels excise tax. This provision exempts motor carriers from taxation as to the Minnesota use of gasoline and special fuels bought in states which have reciprocal provisions in their law exempting the use or consumption of gas and special fuels bought in Minnesota. North Dakota is currently the only state which has these provisions.

It should be noted that the estimates below have not been reduced by the amount that Minnesota would lose if refunds were provided for North Dakota based motor carriers on the portion of their Minnesota purchases used elsewhere. Those refunds would not in all cases be required if this provision were eliminated, but, if they were counted, Minnesota would still show a net loss for the existence of this provision. Those refunds were not counted below because when a fiscal impact of a tax expenditure is estimated, everything else is held constant.

This exemption was enacted in 1961 and has not been changed since that time.

Fiscal Impact

FY 1984	$460,000
FY 1985	460,000
FY 1986	460,000
FY 1987	460,000

REFUNDS

6.03 REFUND FOR OUT-OF-STATE DRIVING (SPECIAL FUELS)

Minnesota Statutes, Section 296.17, Subd. 3

Definition
Common carriers may claim a refund or credit for the tax paid on gasoline or special fuel which is purchased in Minnesota but used or consumed in another state. Because the gasoline tax base is specifically limited to gasoline used on Minnesota highways, this is a tax expenditure only as to special fuels. See the introduction to this chapter for a discussion of the tax bases for the motor fuels excise taxes.

This provision was enacted in 1943 and last changed in 1983. Language differentiating special fuels was introduced in 1957.

Fiscal Impact

FY 1984	$2,600,000
FY 1985	2,900,000
FY 1986	3,100,000
FY 1987	3,400,000

SPECIAL RATES

6.04 BORDER RATES

Minnesota Statutes, Section 296.02, Subd. 1

Definition
When the excise tax on any fuel sold at a Minnesota service station located within 7.5 miles of a service station in a contiguous state is more than three cents higher than the tax levied on the same fuel in the bordering state, the Minnesota excise tax is reduced to three cents over the bordering state's rate for the affected Minnesota service station. The estimates below are for gasoline and special fuels excise taxes. The current excise tax rates for border states are:

State	Motor Fuels Tax Rate Per Gallon
•Minnesota	17¢
Iowa	13¢ on gas / 15.5¢ on diesel
North Dakota	13¢
South Dakota	13¢
Wisconsin	16¢

This provision was enacted in 1981 and last revised in 1983.

Fiscal Impact

FY 1984	$110,000
FY 1985	220,000
FY 1986	220,000
FY 1987	220,000

6.05 GASOHOL RATES FOR GENERAL PUBLIC (GASOLINE)

Minnesota Statutes, Section 296.02, Subd. 7

Definition
Gasohol, defined as gasoline containing at least ten percent agricultural ethyl alcohol, is taxed at a reduced rate. Currently the gasohol tax rate is 15 cents per gallon, two cents per gallon lower than the normal highway gasoline excise tax rate. On July 1, 1985, this rate will be reduced to 13 cents per gallon.

The provision allowing the reduced rate for gasohol was enacted by the Legislature in 1980 and was last amended in 1983.

Fiscal Impact

FY 1984	$ 360,000
FY 1985	710,000
FY 1986	2,100,000
FY 1987	2,800,000

6.06 GASOHOL RATES FOR GOVERNMENTAL UNITS AND SCHOOLS (GASOLINE)

Minnesota Statutes, Section 296.02, Subd. 8

Definition
Effective January 1, 1984, gasoline which contains not less than ten percent agricultural ethyl alcohol is taxed at nine cents per gallon, when purchased in bulk by governmental units or schools. This rate is eight cents lower than the normal gasoline tax rate. See item 6.05 for a related discussion.

This provision was enacted by the Legislature in 1983.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 7: INTOXICATING LIQUORS TAXES

INTRODUCTION

An excise tax is imposed on all distilled spirits, malt beverages (including beer), wines, and pre-mixed alcoholic beverages imported, manufactured, sold, or in the possession of any person in the state. This tax was first imposed in 1934 at rates of $1 per barrel of beer (31 gallons) and $.60 per gallon of wine or liquor. Currently the following rates apply:

Fermented Malt Beverages:	Tax per Barrel
3.2% or less alcohol by weight	$2.00
More than 3.2% alcohol by weight	$4.00
Distilled Spirits:	Tax per Liter
All distilled spirits	$1.16
Wines:	
14% or less alcohol by volume	$ .07
14% to 21% alcohol by volume	$ .21
21% to 24% alcohol by volume	$ .42
over 24% alcohol by volume	$ .81
Sparkling wines	$ .40

The tax is collected monthly from licensed wholesalers, distributors, or manufacturers upon acquisition for sale within Minnesota.

All revenues from these taxes are deposited in the general fund of the state treasury. The fiscal year 1984 combined collections represented 1.1% of total state tax revenues. The fiscal year 1984 amounts collected were:

Distilled spirits	$39,175,000
Wine	3,074,000
Fermented Malt Beverages	11,659,000
Total	$53,908,000

EXEMPTIONS

7.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Section 340.601

Definition
Any person who may legally consume alcohol in Minnesota may bring into this state specified quantities of intoxicating liquor from another state or country without paying the appropriate Minnesota excise tax. A person may bring into Minnesota from another state one liter of distilled spirits, wine, or nine quarts of fermented malt beverages without paying the excise tax. A person entering Minnesota from another country may have in his possession four liters of distilled spirits or wine or ten quarts of beer without paying the Minnesota excise tax.

Section 340.601 was enacted by the Legislature in 1947 and last changed in 1976.

Fiscal Impact

	Distilled Spirits	Wine	Fermented Malt Beverages	Total
FY 1984	$1,000,000	$100,000	$120,000	$1,220,000
FY 1985	1,000,000	100,000	120,000	1,220,000
FY 1986	1,000,000	100,000	120,000	1,220,000
FY 1987	1,000,000	100,000	120,000	1,220,000

7.02 ALCOHOLIC BEVERAGES SOLD TO FOOD PROCESSORS

Minnesota Statutes, Section 340.485, Subd. 1

Definition
Alcoholic beverages sold to food processors are exempt from the intoxicating liquors tax. This provision primarily affects liquor sold to bakeries for use in fruit cakes and other such specialty items. Because of the limited quantities of liquor involved, this provision results in a very small revenue impact to the state.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

7:03 CONSUMPTION ON BREWERY GROUNDS (FERMENTED MALT BEVERAGES)

Minnesota Statutes, Section 340.47, Subd. 2

Definition
All fermented malt beverages given away without charge in a brewery for consumption on the premises are exempt from Minnesota excise tax. This provision applies to malt beverages given to brewery employees and malt beverages given persons touring breweries.

This provision was enacted in 1941 and remains unchanged.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

7.04 BREAKAGE OR DESTRUCTION AT A WHOLESALER'S WAREHOUSE (DISTILLED SPIRITS AND WINE)

Minnesota Statutes, Section 340.485, Subd. 1

Definition
Liquor or wine (bottles) broken or destroyed while in transit to, or in storage at, a wholesaler's warehouse is exempt from Minnesota excise taxes, provided such breakage or destruction is verified by the Minnesota

Department of Revenue. Under no circumstances is this exemption allowed for breakage which occurs after the goods leave the wholesaler's warehouse.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

7.05 WINE USED IN PRODUCTION PROCESS

Minnesota Statutes, Section 340.485, Subd. 1

Definition

The excise tax imposed on the production of wine in Minnesota exempts wine which is used for tasting and testing purposes and wine which is ruined prior to sale.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

7.06 HOME FERMENTATION (WINE AND BEER)

Minnesota Statutes, Section 340.47, Subd. 1

Definition

No excise tax is placed upon beer or wine made in the home for family use. The estimated fiscal impact for this provision assumes that households comply with federal provisions prohibiting a household from making more than 200 gallons of beer and wine per year.

This exemption was first authorized by statute in 1957 and has remained unchanged.

Fiscal Impact

FY 1984	$160,000
FY 1985	160,000
FY 1986	160,000
FY 1987	160,000

7.07 WINE FOR SACRAMENTAL PURPOSES

Minnesota Statutes, Section 340.50

Definition

Sales of wine for sacramental purposes by any manufacturer or wholesaler to any regularly appointed and ordained minister, rabbi, priest, or pastor of any church or established religious organization are not subject to the payment of Minnesota intoxicating liquors tax. Approximately 2,000 liters of wine are sold for sacramental purposes per month in Minnesota.

This provision was adopted in 1937 and remains unchanged.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CREDITS

7.08 MINNESOTA BREWERS' CREDIT (FERMENTED MALT BEVERAGES)

Minnesota Statutes, Section 340.47, Subd. 2 and 2a

Definition
Any brewer producing and selling fermented malt beverages within Minnesota receives a credit of $2 per barrel on the first 75,000 barrels produced and sold each year.

This provision was enacted in 1976 and remains unchanged.

Fiscal Impact

FY 1984	$390,000
FY 1985	390,000
FY 1986	390,000
FY 1987	390,000

SPECIAL RATES

7.09 MINNESOTA VINTNERS' RATES (WINE)

Minnesota Statutes, Section 340.436

Definition
Wines manufactured or produced by a Minnesota farm winery are taxed at lower rates than are wines produced outside Minnesota.

	Tax Rate Per Liter of Wine	
Percent of Alcohol by Volume	Produced Outside Minnesota	Minnesota Farm Winery
14% or less	$0.07	$0.04
14% - 21%	0.21	0.13
21% - 24%	0.42	0.13
More than 24%	0.81	0.13
Sparkling wines	0.40	0.13

Currently only wine that has an alcohol content of 14% or less is produced in Minnesota.

The Legislature enacted this provision in 1980 and has not altered it since then.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 8: TOBACCO TAXES

INTRODUCTION

An excise tax was first imposed on cigarettes in 1947 and on tobacco products in 1955. The initial rate was three cents per pack for cigarettes and 15% of the wholesale price for tobacco products. A complementary use and storage tax was also imposed on cigarettes in 1949 and on tobacco products in 1957.

Total tax collections result primarily from the sale of cigarettes and tobacco products. However, if a Minnesota consumer has in his possession cigarettes and/or tobacco products upon which the Minnesota excise tax has not been paid, a use and storage tax is imposed. The use and storage tax is imposed at the same rate as if there were a Minnesota sale of cigarettes or tobacco products. Currently the rates are $.18 per pack of 20 cigarettes or little cigars and 20% of the wholesale price for other tobacco products. Tobacco products include all tobacco products except cigarettes and little cigars.

Collections of cigarette and tobacco taxes were $84.7 million for fiscal year 1984. The Department of Revenue collects these taxes from distributors of cigarettes or tobacco products. All revenues from the tobacco products taxes are deposited in the general fund of the state treasury. Revenues from the cigarette taxes are credited 89% to the state's general fund, 5.5% to the natural resources account, and 5.5% to the natural resources acceleration account. All cigarettes and tobacco products are also subject to the general sales and use tax, as of 1982. Tobacco products were always taxable under the sales tax as personal property. Cigarettes had been specifically exempt until 1982.

EXEMPTIONS

8.01 SALES TO MINNESOTA CORRECTIONAL INSTITUTIONS

Minnesota Statutes, Sections 297.02, Subd. 6 and 297.32, Subd.8

Definition
Institutions under the control and management of the Commissioner of Corrections are specifically exempt from the cigarette excise tax and the tobacco products tax. This tax expenditure occurs when prisons and other correctional institutions buy cigarettes and other tobacco products on a regular basis to sell to inmates, consequently the inmates do not pay the tax. No other state agencies or institutions are granted this exemption.

This exemption was authorized in 1965 and remains unchanged.

Fiscal Impact

	Cigarettes	Tobacco Products	Total
FY 1984	$120,000	$4,000	$124,000
FY 1985	120,000	6,000	126,000
FY 1986	110,000	7,000	117,000
FY 1987	110,000	9,000	119,000

8.02 LIMITED QUANTITIES EXEMPT

Minnesota Statutes, Sections 297.22, Subd. 3 and 297.32, Subd.2

Definition
A use and storage tax equal to the cigarette tax is imposed on consumers in possession of cigarettes (or little cigars) which were not previously subject to the Minnesota cigarette excise tax.

Likewise, a use and storage tax equal to the tobacco products tax is imposed on consumers in possession of tobacco products not previously subject to the tobacco products tax.

For both taxes, limited quantities in the possession of a consumer are exempt from the tax. The exemption applies to:

1. Not more than 200 cigarettes;
2. Not more than 50 cigars;
3. Not more than ten ounces of snuff or snuff powder;
4. Not more than one pound smoking or chewing tobacco or other tobacco products not specifically mentioned in the statutes.

Although this exemption could be viewed as an incentive for consumers to purchase cigarettes and tobacco products in bordering states with lower tax rates, only North Dakota and South Dakota have lower cigarette tax rates. It is doubtful that a tax difference of three cents a pack is enough of an incentive for consumers to consistently go out of state to purchase cigarettes.

State	Cigarette Tax Rate Per Pack
Minnesota	18¢
North Dakota	18¢
South Dakota	15¢
Iowa	18¢
Wisconsin	25¢

The exemption for cigarettes was enacted in 1949 and was last changed in 1973. The exemption for tobacco products was enacted in 1957 and revised in 1971.

Fiscal Impact

	Cigarettes	Tobacco Products	Total
FY 1984	$360,000	$10,000	$370,000
FY 1985	360,000	10,000	370,000
FY 1986	360,000	10,000	370,000
FY 1987	360,000	10,000	370,000

CHAPTER 9: MORTGAGE REGISTRY TAX

INTRODUCTION

This tax was enacted in 1907 at a rate of $.50 for each $100 of mortgage debt registered. The tax is levied on the face value of a mortgage which is secured by property located in Minnesota. The tax is imposed once on any mortgage or extension of the mortgage. Only mortgages registered or recorded are subject to tax. Recording or registering a mortgage gives the lender certain legal rights and privileges. In practice the tax is paid by the party who registers or records the mortgage, presumably the lender. The current rate for this tax is $.15 for each $100 of mortgage debt.

County governments collect this tax and retain 5% of collections. The balance is deposited in the general fund of the state treasury. In fiscal year 1984, the state's share of mortgage registry taxes was $13.3 million.

EXEMPTIONS

9.01 CERTAIN PERSONS AND ORGANIZATIONS EXEMPT

Minnesota Statutes, Section 287.06

Definition
Organizations which are exempt from the property tax, such as municipalities, churches, and school districts, are exempt from the mortgage registry tax when they are the mortgage lender. This exemption is based on the identity of the lender because it is the lender who pays the tax in order to officially register its security interest in the affected property. For example, if a church loans money to someone to build a house, the registration of that mortgage would not be taxed because the tax would have been levied on a church. However, if the same church were to borrow money from a bank to build the same house, the registration of the mortgage would be subject to tax because the tax is now levied on a bank.

This provision was enacted in 1907 and was last revised in 1965.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 10: DEED STAMP TAX

INTRODUCTION

The deed stamp tax was first enacted in 1961 at a rate of $1.10 per $1,000 of consideration given when real estate is transferred by deed, instrument or writing. Currently the tax rate is $2.20 for the first $1,000 or fraction of $1,000 of consideration, and $1.10 for each $500 or fraction of $500 of consideration above $1,000. Generally, the seller pays the tax because he is the person who transfers the property. By law county recorders must refuse to record or register any deed, instrument or writing if the deed tax has not been paid.

All revenues from this tax go to the general fund of the state. In fiscal year 1984, this tax raised $13.1 million.

EXEMPTIONS

10.01 TRANSFERS BETWEEN CO-OWNERS

Minnesota Statutes, Section 287.22

Definition
Deeds transferred between co-owners in order to partition a commonly held piece of land are exempt from the deed transfer tax.

This provision became effective August 1, 1984.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

10.02 TRANSFERS INVOLVING GOVERNMENT AGENCIES

Minnesota Statutes, Section 287.22

Definition
This provision exempts from tax any deed, instrument, or writing in which a governmental body or agency is the grantor, assignor, transferor, conveyor, grantee, or assignee. In other words, any time a government agency is one of the parties involved in a deed transfer, no deed transfer tax is imposed.

This provision was enacted in 1961 and remains substantially unchanged since then.

Fiscal Impact

FY 1984	$260,000
FY 1985	290,000
FY 1986	320,000
FY 1987	350,000

10.03 DEEDS FOR CEMETERY LOTS

Minnesota Statutes, Section 287.22

Definition
Deeds or other instruments transferring cemetery lots are exempt from the deed transfer tax.

This provision was enacted in 1961.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 11: TELEPHONE COMPANIES GROSS EARNINGS TAXES

INTRODUCTION

A gross earnings tax was first imposed upon telephone companies in 1887 at a two percent rate. In 1891 this tax was repealed and replaced with an ad valorem tax until 1897 when the tax upon gross earnings was re-enacted at a three percent rate. In 1921, the gross earnings tax rate was increased to four percent, and, in 1937, the present schedule of rates, which vary by size of community served, was established.

According to the language of Minnesota Statutes, Section 295.34, the gross earnings tax on telephone companies is in lieu of all other state taxes and property taxes except for income taxes. Every company owning or operating telephone lines or telephone exchanges for hire, either wholly or partly within the state, is subject to a tax equal to the following percentages of their gross earnings derived from business within Minnesota:

Gross earnings derived from business within cities of the fourth class (having a population of 10,000 or less)	4% of gross earnings
Gross earnings from service to rural subscribers	4% of gross earnings
Gross earnings from all other sources	7% of gross earnings
Special rate for companies with annual gross earnings of $1,000 or less	$.30 per telephone

In fiscal year 1984, $69.9 million in telephone gross earnings taxes were collected. All revenues from this tax are credited to the state's general fund.

SPECIAL RATES

11.01 FOUR PERCENT RATE

Minnesota Statutes, Section 295.34, Subd. 1

Definition
Telephone companies having gross earnings of more than $1,000 for the calendar year are taxed at a percentage of their gross earnings. Gross earnings received from rural subscribers, or from exchange business in cities of the fourth class (those having a population of 10,000 or less) are taxed at four percent. All other gross earnings are taxed at a seven percent rate.

The gross earnings tax on telephone companies was enacted in 1887 at a flat two percent rate. The preferential rate for gross earnings received from rural or small city customers was introduced in 1937, when the current tax rates were enacted.

Fiscal Impact

FY 1984	$13,000,000
FY 1985	14,000,000
FY 1986	15,000,000
FY 1987	16,000,000

CHAPTER 12: INSURANCE PREMIUMS TAXES

INTRODUCTION

This section includes three different taxes paid by insurance companies. The first is the gross premiums tax imposed on gross premiums generally. This tax was first enacted in 1868 at a two percent rate. The current rate remains at two percent for most premiums except surplus line insurance, which is taxed at a three percent rate. The tax base is gross premiums on all business received in Minnesota less premiums returned to customers and dividends on premiums credited to customers.

The second tax is the fire marshal tax and is imposed in addition to the tax on gross premiums. The fire marshal tax is a gross premiums tax specifically on fire premiums. This tax was first enacted in 1945 at a 0.375% rate. Currently the rate is 0.5%. The tax is imposed on gross premiums received in Minnesota on fire risks less returned premiums.

The third tax, the ocean marine profits tax, is a tax on marine insurance issued in the state. This tax was enacted in 1953 at a five percent rate. The tax is levied on the underwriting income earned on marine premiums. Marine underwriting profits are still taxed at the 1953 level of five percent.

Revenues from these taxes go to the general fund of the state treasury. In fiscal year 1984, those revenues amounted to $70.8 million.

EXEMPTIONS

12.01 COOPERATIVE LIFE AND CASUALTY COMPANIES

Minnesota Statutes, Section 61A.49

Definition
Although cooperative companies perform the same function as other life and casualty insurers, all cooperative life and casualty insurance companies are exempt from the Minnesota gross premiums tax.

This exemption was enacted in 1907 and was last changed in 1967.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

12.02 AUTO AND OCEAN MARINE FIRE PREMIUMS OF DOMESTIC MUTUAL INSURANCE COMPANIES

Minnesota Statutes, Section 60A.15, Subd. 2

Definition
Although domestic (i.e., Minnesota) mutual insurance companies are generally subject to the two percent gross premiums tax on direct fire, lightning, and sprinkler leakage premiums, all of their premiums from auto and ocean marine fire business are exempt from the tax.

This exemption was enacted in 1905 and was last changed in 1971.

Fiscal Impact

FY 1984	$490,000
FY 1985	520,000
FY 1986	570,000
FY 1987	650,000

12.03 FRATERNAL BENEFICIARY ASSOCIATIONS

Minnesota Statutes, Section 64A.44

Definition
Fraternal beneficiary societies or associations are exempt from the Minnesota gross premiums tax. These associations are nonprofit, charitable organizations which provide life, sickness, and/or accident benefits for their members. Examples of fraternal beneficiary associations include the Sons of Norway, the Knights of Columbus, and the Catholic Aid Association. Although the estimates below measure only the impact of the exemption from the gross premiums tax, these fraternal organizations are also exempt from most other state taxes (see item 2.01).

This exemption dates back to 1907. Minnesota Statutes, Section 64A.44 was enacted in 1967 and has not been changed since that time.

Fiscal Impact

FY 1984	$1,700,000
FY 1985	1,800,000
FY 1986	2,000,000
FY 1987	2,200,000

12.04 MEDICAL AND HOSPITAL SERVICE ASSOCIATIONS

Minnesota Statutes, Section 62C.01, Subd. 3

Definition
Medical and hospital service associations organized and controlled by state law under the Minnesota Non-Profit Health Service Plan Corporations Act are excluded from the gross premiums tax.

This provision was enacted in 1971 and has remained unchanged since that time.

Fiscal Impact

FY 1984	$6,300,000
FY 1985	6,700,000
FY 1986	7,100,000
FY 1987	7,500,000

12.05 FARMERS' MUTUAL AND TOWNSHIP MUTUAL FIRE INSURANCE COMPANIES (FIRE MARSHAL TAX)

Minnesota Statutes, Section 299F.21

Definition
Insurance companies doing business in Minnesota are required to pay an annual fire marshal tax on their fire insurance premiums. The tax is equal to one-half percent of gross fire insurance premiums and assessments received annually on all direct business in Minnesota. Farmers' mutual insurance companies and township mutual insurance companies are exempt from this tax.

This exemption was enacted by the Legislature in 1915 and has not been changed since that time.

Fiscal Impact

FY 1984	$130,000
FY 1985	140,000
FY 1986	150,000
FY 1987	170,000

CREDITS

12.06 PAYMENTS TO MINNESOTA COMPREHENSIVE HEALTH ASSOCIATION

Minnesota Statutes, Section 62E.11, Subd. 8

Definition
Insurance companies may take a credit aganist the gross premiums tax in an amount equal to their contributions during the tax year to the Minnesota Comprehensive Health Association (MCHA). The MCHA was established by the state Legislature as a vehicle to provide insurance for high risk individuals. By law, membership in the association consists of all insurers, self-insurers, and fraternal and health maintenance organizations licensed or authorized to do business in the state. All members subject to the Minnesota gross premiums tax must make an annual contribution to the association based on their gross premium income.

This provision was enacted in 1979 as a credit against either the corporate income or the gross premiums tax, at the taxpayer's election (see item 2.41). In 1984 the credit was changed so that effective for tax years beginning after December 31, 1983, the credit may be applied only against the gross premiums tax.

Fiscal Impact

FY 1984	$3,400,000
FY 1985	3,600,000
FY 1986	3,800,000
FY 1987	3,900,000

PREFERENTIAL COMPUTATIONS

12.07 THREE YEAR AVERAGING (OCEAN MARINE PROFITS TAX)

Minnesota Statutes, Section 60A.15, Subd. 6

Definition
Ocean marine insurance companies must average their net underwriting profits (or losses) from the three previous calendar years when determining current tax liability under the ocean marine profits tax. This provision is a tax expenditure to the extent that it reduces a taxpayer's liability.

This provision was enacted in 1953 and has not been changed since that time.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 13: TACONITE PRODUCTION TAX

INTRODUCTION

The taconite production tax was first enacted in 1941 at a rate of $.05 per ton of concentrate produced in a calendar year, plus an additional tax of $.01 per ton for each 0.5% that the iron content of the concentrate exceeded 55%. Production taxes are imposed on the concentration of four types of low grade ore. Currently only one type of low grade ore-taconite-is being taxed. The tax rates for the other three types of ore are the same as the initial 1941 rate but are not applicable to any current mining or concentrating activity within the state.

The current taconite tax rate is $1.25 per ton of concentrate produced, plus an additional tax if the iron content of the concentrate exceeds 62%. In certain years the rate is adjusted for increases in the average price of products of steel mills, while in 1985 and beyond there will be no additional tax based on iron content.

The tax is calculated by multiplying the number of tons of concentrate produced in a year by the tax rate. Due to a 1984 law change, the computation of tons produced is different for each year, 1983 through 1986. The table below indicates how tons produced is computed. Under current law the computation of tons produced will remain the same beyond 1986.

Year	Computations of Tons Produced
1983	Higher of current year's production or an average of current year's production and two previous years' production
1984	Current year's production
1985	Average of current year's production and 1984 production
1986	Average of current year's production and two previous years' production

The production tax is in addition to the occupation, royalty, and excise taxes on taconite producing activity but is in lieu of property taxes on the land, buildings, and equipment associated with the production of the concentrate.

In fiscal year 1984, total taconite production tax revenues were $67.3 million. Of the total taconite production tax revenues, an amount equal to one cent per ton is deposited in the general fund of the state treasury. The remaining revenues are either distributed to certain local units of government or dedicated for use within northeastern Minnesota.

CREDITS

13.01 WATER FILTRATION PLANT CREDIT

Minnesota Statutes, Section 298.24, Subd. 4

Definition
Any taconite producer constructing a qualified water filtration and treatment plant in 1984 at a cost of more than $1,000,000 may claim an annual credit of $250,000. The credit may be applied against production taxes paid in 1985, 1986 and 1987.

This credit was enacted in 1984.

Fiscal Impact

FY 1984	None
FY 1985	$250,000
FY 1986	250,000
FY 1987	250,000

CHAPTER 14: MINING OCCUPATION TAXES

INTRODUCTION

The mining occupation tax was first enacted in 1921 at a six percent rate. This tax is imposed on every person in the business of mining or producing iron or other ore in Minnesota, and the tax is in lieu of the corporate income tax. Although somewhat similar to an income tax, the occupation tax does not allow as many expenses in computing its equivalent of taxable income. The equivalent of gross income for this tax is the Lake Erie market value of the ore produced in a calendar year. The Lake Erie value is used because there is no published market value of iron ore in Minnesota. The taxable value of the ore is the Lake Erie price minus the cost of mining the ore, the cost of concentrating the ore, and the cost of transporting the ore from Minnesota to Lake Erie ports. Depletion is an example of an item allowed in computing corporate tax liability but not allowed in computing occupation tax liability.

Currently the tax rate for natural iron ore is 15.5% and it is 15% for taconite. The rate for both will be 15% in 1985 and thereafter. No other types of ore are currently being mined or produced in Minnesota.

A labor credit reduces the statutory rate of 15% to an effective rate of 6.75% for taconite companies and reduces the statutory rate to an effective rate of about 14% for natural ore companies. Beginning in 1985 natural ore companies will be allowed the same labor credit as taconite companies and their effective rate will be reduced to 6.75% also.

This tax is collected from the mining companies, but collections are limited by a state constitutional provision explained below. The fiscal impacts for the tax expenditures in this chapter were computed without regard to the potential effect of that constitutional provision. For additional information on the limitation, see the discussion on page 142.

All revenues from the occupation tax on iron ore and taconite are deposited in the general fund of the state treasury with 50% of those revenues being dedicated to the support of education and the equivalent of one cent per ton being dedicated to the iron range resource and rehabilitation board. In fiscal year 1984, this tax generated $2.9 million of total revenues.

CREDITS

14.01 LABOR CREDIT

Minnesota Statutes, Section 298.02

Definition
Persons in the business of mining or producing iron ore and taconite may claim a credit against occupation taxes equal to a percentage of their annual labor costs. The credit is determined by a formula based on the cost of labor per ton of processed iron ore or concentrate. During calendar years 1983 and 1984, there were two limitations on the labor credit: one for taconite operations and one for all other operations. These limitations place a cap on how much credit a taxpayer may claim. Beginning with calendar year 1985, the same limitation will apply to both types of operations and will result in an industry-wide effective tax rate of about 6.75%.

The labor credit was enacted in 1939 and was last changed in 1984.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	$14,000,000
FY 1985	18,000,000
FY 1986	18,000,000
FY 1987	18,000,000

14.02 POLLUTION CONTROL CREDIT

Minnesota Statutes, Section 298.028

Definition
Companies engaged in mining taconite or other iron bearing ores in Minnesota may take a credit against the occupation tax equal to five percent of the net cost of equipment used primarily to abate or control pollutants in order to meet state standards. The credit amount is limited to $75,000 for any single tax year. However, excess credit amounts may be carried forward for up to four successive years.

The pollution control credit was enacted in 1979 and remains unchanged.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

14.03 RESEARCH, EXPERIMENTATION, AND EXPLORATION CREDIT

Minnesota Statutes, Section 298.026

Definition
An occupation tax credit is allowed each Minnesota mining operation for the cost of all research, experimentation, pilot plant tests, and exploration work performed in Minnesota for the express purpose of furthering the discovery, development, or beneficiation (concentration) of Minnesota ores. Credit amounts exceeding current tax liability may be carried forward up to two years.

This provision was enacted in 1963 and was last changed in 1976.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	$200,000
FY 1985	280,000
FY 1986	280,000
FY 1987	280,000

14.04 LOSS MINE CREDIT (OTHER THAN TACONITE)

Minnesota Statutes, Section 298.027

Definition
An occupation tax credit may be claimed by other than taconite taxpayers when allowable costs of a mine's operation (i.e., reasonable expenses) exceed the value of the ore at the place where the ore is brought to the surface of the earth. The credit is limited to a specified percentage of the loss, depending on the type of mining operation. The credit is allowed only for the year in which the excess occurs.

The loss mine credit was enacted in 1963 and was last changed in 1976.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

14.05 DISCOUNT CREDIT (OTHER THAN TACONITE)

Minnesota Statutes, Section 298.031

Definition
A tax credit is allowed all mining companies, other than taconite, for iron ore which is sold at a discount. The credit amount is determined by multiplying the number of tons of ore sold at a discount by the amount of the discount as determined by the Commissioner of Revenue. The aggregate of all discount credits allowed in any year cannot exceed one percent of the aggregate amount of all occupation taxes prior to the deduction of this credit, assessed against all mines in the state for the same year.

The discount credit was enacted by the Legislature in 1961 and was last changed in 1984.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CHAPTER 15: ROYALTY TAXES

INTRODUCTION

The royalty tax was enacted at a six percent rate in 1923. The tax is imposed on royalties paid to owners of mineral rights. The tax rate depends on the mineral for which the royalty is paid. In 1983 and 1984 the rate for iron ore royalties is 15.5% and it is 15% for taconite royalties. Beginning in 1985 the tax rate will be 15% for both iron ore and taconite royalties. Generally, the rate for all other metals is 15.5%, however for copper-nickel royalties it is one percent plus an additional one percent for royalties paid on silver, gold, platinum and other precious metals. The statutory rate may be reduced by a labor credit. If a labor credit was taken against the occupation tax, the same credit may be taken against the royalty tax in order to make the effective rate for the royalty tax the same as it is for the occupation tax paid on the mining activity generating the royalties being taxed.

The royalty tax is imposed on royalties received during a calendar year. The Department of Revenue collects the tax from the mining company which pays the royalty. The lease between the mining company and the owner of the mineral rights determines who actually absorbs the tax.

Collections of this tax are limited by a state constitutional provision explained on page 142. The fiscal impacts for the tax expenditures in this chapter were computed without regard to the potential effect of that constitutional provision. For additional information on the limitation, see the discussion following this chapter.

All royalty tax revenues, $3.8 million in fiscal year 1984, are credited to the general fund of the state treasury.

CREDITS

15.01 LABOR CREDIT

Minnesota Statutes, Section 299.012

Definition
Taxpayers receiving royalties from a taconite or other ore operation may claim a labor credit in an amount which will cause the net effective tax rate to equal the net effective mining occupation tax rate for the same operation. See item 14.01 for a discussion of the occupation tax labor credit.

This provision was enacted in 1959 and was last amended in 1973.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	$5,100,000
FY 1985	3,400,000
FY 1986	3,900,000
FY 1987	3,900,000

15.02 LOSS MINE CREDIT

Minnesota Statutes, Section 299.012, Subd. 1

Definition
A credit is allowed against the royalty tax when the allowable costs of a mine operation (i.e., reasonable costs) exceed the value of the ore at the place where the ore is brought to the surface of the earth. The credit is equal to 8.25% for underground, taconite, and semi-taconite operations, and 6.6% for all other operations. Currently, this credit is claimed only by other than taconite or semi-taconite operations.

This provision was enacted in 1959 and was last changed in 1984.

Fiscal Impact (computed without regard to constitutional limitation)

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CONSTITUTIONAL LIMIT — TACONITE COMPANIES

CONSTITUTIONAL LIMIT ON THE TAXATION OF TACONITE MINING COMPANIES

Minnesota Constitution, Article X, Section 6; Minnesota Statutes, Section 298.40

Definition
The state constitution places a ceiling on the combined amount of occupation, royalty, and sales taxes to be paid in any one year by each of the taconite mining firms. The ceiling is based on a hypothetical tax calculation for each company, reflecting either the mining tax laws as they existed in 1963 or the current corporate income tax laws for manufacturing concerns. Each firm's total payment of occupation, royalty, and sales taxes may not exceed its ceiling amount.

Therefore, for taconite mining companies, there is no fiscal impact for any occupation, royalty, or sales tax expenditure if each taconite company is already paying occupation, royalty, and sales taxes at or above its tax ceiling amount. There will be a tax expenditure fiscal impact only if some taconite firms have current occupation, royalty, and sales tax payments of less than their tax ceiling.

In fiscal year 1984, taconite firms as a group paid $4,500,000 less than their constitutional limits. Consequently, the maximum fiscal impact of occupation, royalty, and sales tax expenditures associated with taconite mining firms is $4,500,000. The projection of fiscal years 1985, 1986, and 1987 tax expenditure maximum fiscal impacts ideally would be based on projections of each firm's occupation, royalty, and sales taxes payments and a projection of each firm's tax ceiling. Because there is no way to project each of these amounts, the 1984 maximum fiscal impact figure is used to approximate the maximum fiscal impact for fiscal years 1985, 1986, and 1987.

The constitutional tax ceiling was passed by the Legislature in 1963 and adopted by the voters in 1964. It is set to expire in 1989.

Fiscal Impact
(Maximum possible fiscal impact for all occupation, royalty, and sales tax expenditures affecting taconite mining firms.)

FY 1984	$4,500,000
FY 1985	4,500,000
FY 1986	4,500,000
FY 1987	4,500,000

CHAPTER 16: GENERAL PROPERTY TAX

INTRODUCTION

The general property tax in Minnesota dates back to territorial days when it was the prime source of tax revenues in the state. Today, the state of Minnesota itself does not levy a general property tax; only local units of government levy direct taxes on property. Because of this, only local units of government are affected by the tax expenditures in this tax. There is an indirect effect on state revenues to the extent that state-funded property tax aids and credits are based on property taxes paid by certain classes of property; however, the measurement of that type of secondary impact from tax expenditure provisions is beyond the scope of this report.

Historically, the property tax has been levied on two types of property — real and personal. Real property is land and its improvements. Personal property is divided into tangible and intangible types. Examples of tangible personal property include such things as inventories, machinery, and household goods. Currently, most tangible personal property is exempt from the property tax. Intangible personal property includes such things as stocks, bonds, or legal rights such as patents or copyrights. Since 1945, all intangible property has been exempted from the property tax.

The beginning point for the computation of the property tax is the determination of the market value of the property being taxed. A local assessor determines the market value of the property. There is a state review process to determine whether consistent methods were used in assigning market values. Next, the property is classified by type and the appropriate assessment rate, which may range from 5% to 50%, is applied to the assessor's market value for the property. The result is the assessed, or taxable, value of the property. The assessment rate to be applied to the property depends on whether the property is real or personal, and the use of the property. Together, all of the assessment rates are referred to as the classification system.

The gross tax is computed by multiplying a mill rate times the taxable value of the property. The level of the mill rate depends on the fiscal needs of the local units having authority to levy against the affected property. The gross tax may be reduced by one of nine credits (listed below), to arrive at net tax. Because open and standing appropriations fund the cost of all property tax credits except for the power line credit, they are not classified as tax expenditures. The power line credit is classified as a tax expenditure (item 16.05).

Property tax credits:

1. Agricultural Aid Credit
2. Wetlands Credit
3. Native Prairie Credit
4. Reduced Assessment Credit
5. Power Line Credit
6. Homestead Credit and Taconite Homestead Credit
7. Property Tax Refund
8. Agricultural Preservation Credit
9. Enterprise Zone Property Tax Credit

In general, the tax expenditure fiscal impacts for this tax measure the difference between current net taxes and net taxes computed without tax expenditure provisions given current law tax rates.

Please note: the classification system tax expenditure estimates in item 16.02 measure the changed distribution of the net property taxes with and without the current classification system.

EXEMPTIONS

16.01 EXEMPT PROPERTY

Minnesota Statutes, Section 272.02, Subd. 1 and 273.18

Definition
Certain types of property are exempt from the property tax by statute. Because of data limitations, the exempt property included in the fiscal impact below is essentially the statutorily exempt property which has traditionally not been taxable in Minnesota. Other property exempted by statute is included in item 16.02 on the classification system.

Certain other types of property are exempt under either the Minnesota Constitution or federal law. These properties are churches, academies, colleges, universities, and Indian reservations. Their exemption is not included in the tax expenditure.

Since 1926 the county assessors have been required to value exempt property every six years. The last valuation of exempt property took place in 1980, and the 1980 values are used here, with no growth assumed. Those values were multiplied by a 43% assessment rate and a statewide average mill rate computed or estimated for each year to arrive at the estimated net property tax figures shown below. Those figures do not represent taxes currently being paid by property that is taxable; they represent additional net taxes that would be collected if exempt property were taxed at current mill rates. If exempt property were taxed, those rates would be lower, as would be the resultant tax relief afforded property which is currently taxable.

Certain types of property have been exempt from taxation since at least 1851 when the first book of statutes was compiled for the Territory of Minnesota. The statute was last changed in 1984.

Fiscal Impact

	Property Tax Increase
FY 1984	$415,000,000
FY 1985	444,000,000
FY 1986	474,000,000
FY 1987	505,000,000

	Net Property Tax (Fiscal Years)			
Type of Property	1984 (000's)	1985 (000's)	1986 (000's)	1987 (000's)
Real Property:				
Elementary and secondary schools	$152,513	$163,202	$173,895	$185,287
Public burying grounds	3,551	3,800	4,049	4,314
Hospitals	46,228	49,468	52,709	56,162
Charitable institutions	18,148	19,420	20,693	22,048
Federal and state forests, parks and wildlife refuges	28,494	30,491	32,488	34,617
Public property used for public purposes	166,338	177,996	189,658	202,083
Total Real Property	$415,272	$444,377	$473,492	$504,511
Total Personal Property*	59	63	67	71
Total Exempt Property	$415,331	$444,440	$473,559	$504,582

*Personal property includes iron ore stockpiles, direct products of furnaces, and agricultural products. The taxation of other types of exempt personal property is included in item 16.02 on the classification system.

PREFERENTIAL VALUATIONS

16.02 CLASSIFICATION SYSTEM

Minnesota Statutes, Section 273.13

Definition
Although there are some seventy different classes of property for ad valorem tax purposes, the tax expenditure estimates are summarized by twelve major groups. The tax expenditure assumes that, instead of having many different assessment rates, there is one uniform assessment rate. However, no new revenue is generated because the mill rates have been adjusted to reflect the new assessed values. The fiscal impacts therefore reflect shifts in tax burdens only. A positive figure below indicates a tax increase and a negative figure a tax decrease for a group. When the gross tax is computed, the total of the differences between the groups is zero. When the net tax is computed, the differences between groups does not balance to zero due to an increase in tax credits. These estimates include the effect of taxing some types of commercial and industrial property that are not now taxed but which were once subject to taxation (see item 16.01).

The property tax classification system was first enacted in 1913 and last changed in 1984.

Fiscal Impact

(Changes in net property taxes by major groups due to elimination of the classification system)

	Fiscal Year			
Major Group	1984 (000's)	1985 (000's)	1986 (000's)	1987 (000's)
1. Farm	$ 89,587	$ 105,495	$ 103,446	$ 106,496
2. Seasonal Recreational Residential	4,732	5,346	5,629	5,946
3. Seasonal Recreational Commercial	998	1,110	1,197	1,266
4. Residential	158,454	177,979	194,631	212,070
5. Apartments	-32,516	-35,587	-38,285	-40,375
6. Vacant Land	-18,547	-18,669	-20,082	-21,186
7. Commercial*	-149,018	-173,844	-182,221	-193,105
8. Industrial*	-56,563	-67,561	-72,159	-76,818
9. Public Utility	-20,573	-22,742	-24,489	-25,848
10. Mineral	-1,848	-1,834	-1,915	-1,964
11. Railroad	-5,578	-5,474	-4,260	-4,365
12. Personal	-28,760	-31,758	-34,207	-36,115

*Includes personal property (for example, inventories) and attached machinery currently exempt from tax.

Please note that the differences in net taxes do not equal zero because some groups would receive increased tax credits as a result of eliminating the classification system.

16.03 GREEN ACRES TREATMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 273.111

Definition
In 1967 the Legislature passed the Agricultural Property Tax Law, commonly referred to as the "Green Acres" provisions. That law provides for preferential and deferred assessment of qualifying agricultural land consisting of ten or more acres.

A qualifying parcel is to be valued according to its agricultural use only. A higher value that would result from nonagricultural use is not referenced for property tax purposes. For example, farm land that is near a commercial development would be valued according to its agricultural use and not according to its potential value for commercial development. Also, special assessments for sewer, water and streets are deferred.

When "Green Acres" property no longer qualifies as such or is sold, a tax is due equal to the amount by which the preferential assessment has reduced the property tax for the previous three years. Deferred special assessments also are due at that time.

The estimates below show the increase in net property tax that would result from valuing the "Green Acres" property at its highest and best use as opposed to its agricultural use, given current tax rates.

This provision was enacted in 1967 and last revised in 1984.

Fiscal Impact

	Increase in Net Property Tax
FY 1984	$3,100,000
FY 1985	4,100,000
FY 1986	5,600,000
FY 1987	7,600,000

ALTERNATIVE TAXES

16.04 AUXILIARY FOREST TAX AND TREE GROWTH TAX

Minnesota Statutes, Sections 88.47 to 88.53 and 270.31 to 270.39

Definition

The owner of forest land has the option of having his land taxed under the auxiliary forest tax or tree growth tax rather than the general property tax. In either case, the owner of the affected land must apply to the appropriate county board, and have this application approved, in order to be eligible for this alternative tax treatment. Also in either case, the alternative tax will generally be less than the general property tax.

Auxiliary forest land is annually taxed at ten cents per acre until such time as the owner cuts or otherwise removes merchantable timber from the land. At that time a yield tax is levied on the value of the timber cut or removed. The tax rate varies from 40% to 10% depending on the year of harvest. In order for property to be classified as auxiliary forest land it must be either; 35 acres or more which are suitable for forestation, or a wood lot of from five to 40 acres. No property may be newly classified as auxiliary forest land after June 30, 1974.

The tax rates for property subject to the tree growth tax depend on the type of property involved. Commercial forests pay an annual tax of 30% of the value of annual growth. Temporarily nonproductive forests are taxed at five cents per acre or 15¢ per acre for noncompliance with a reforestation agreement. Permanently nonproductive forest lands are taxed at five cents per acre annually. Owners of forest lands may apply to the county board for a credit equal to tax liability per acre or 50¢ per acre, whichever is less, for each acre on which there is planted and maintained at least 500 trees of a commercial variety. The credit may last only ten years.

Both the auxiliary forest tax and the tree growth tax are payable at the time and in the manner of general property tax levies. Collections from both taxes are distributed in the same manner as general property tax revenues. The revenue impacts below measure the estimated difference between the alternative taxes paid for the affected lands and the net general property tax amounts they would have otherwise paid.

The auxiliary forest tax was enacted in 1927. The tree growth tax was enacted in 1957.

Fiscal Impact

	Tree Growth Tax	Auxiliary Forest Tax	Total
FY 1984	$ 410,000	$350,000	$ 760,000
FY 1985	470,000	390,000	860,000
FY 1986	530,000	420,000	950,000
FY 1987	600,000	450,000	1,050,000

CREDITS

16.05 POWER LINE CREDIT

Minnesota Statutes, Sections 273.42 and 273.425

Definition
The owner of certain types of property, such as a residence or a farm, receives a property tax credit if the property is crossed by an electric transmission line of 200KV or more which was constructed after June 30, 1974. The credit is limited to 20% of the gross property tax for any 40 acre parcel of property. No credit is paid if it is less than $10.

The credit is financed by dedicating a certain portion of the property taxes paid by the transmission lines giving rise to the credit. Any excess in the amounts so dedicated above what is needed to fund the credit is released for distribution to local governmental units as normal property tax revenue. The tax expenditure consists of the portion of transmission line property taxes which are set aside to fund this credit and which are actually used for that purpose.

The power line credit was enacted in 1980 and became effective for property taxes payable in 1982.

Fiscal Impact

FY 1984	$170,000
FY 1985	180,000
FY 1986	200,000
FY 1987	220,000

CHAPTER 17: MOTOR VEHICLE REGISTRATION TAX

INTRODUCTION

The motor vehicle registration tax is imposed on the registration of motor vehicles using the public streets and highways. The tax is imposed when a vehicle is purchased and on an annual basis thereafter. The tax was first imposed in 1911 at a rate of $1.50 per vehicle. The rates were first based on weight and value in 1921. Currently, there are over 20 different classifications of vehicles, with the two major rates as follows:

— Passenger cars and pick-up trucks—$10 plus 1.25% of the base value based on the age of the vehicle.

— Commercial vehicles—$15 for the first 1,500 lbs. with graduated rates for the excess, up to $50 per ton over 81,000 lbs.

The proceeds from this tax are deposited in the highway user distribution fund of the state treasury. The fiscal year 1984 proceeds from this tax were $197.8 million.

EXEMPTIONS

17.01 GOVERNMENT VEHICLES

Minnesota Statutes, Section 168.012, Subd. 1

Definition
Vehicles owned by cities, counties, and other political subdivisions of the state are exempt from payment of the motor vehicle registration tax. Exempt vehicles include government owned ambulances, fire equipment, utility fleets, and police vehicles, as well as fire and emergency vehicles owned by citizen associations, such as volunteer fire associations. Publicly owned school buses, although exempted from tax by this provision, are not included in the estimates below because even if this item were repealed, they would remain exempt under another provision (see item 17.02).

The exemption for government vehicles was enacted in 1921 and was last changed in 1983.

Fiscal Impact

FY 1984	$1,900,000
FY 1985	2,000,000
FY 1986	2,000,000
FY 1987	2,100,000

17.02 EDUCATIONAL INSTITUTIONS — BUSES

Minnesota Statutes, Section 168.012, Subd. 1

Definition
Vehicles which are used by Minnesota educational institutions for the sole purpose of transporting students to and from those institutions are exempt from the motor vehicle registration tax. The estimates below do not include the impact of exempting publicly owned school buses, since publicly owned buses would remain exempt without this provision under the exemption for government vehicles (see item 17.01).

This exemption was enacted in 1933 and has not been changed since then.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

17.03 NONRESIDENT MILITARY PERSONNEL

Minnesota Statutes, Section 168.04

Definition
Vehicles of nonresident military personnel stationed in Minnesota are exempt from the motor vehicle registration tax, provided they meet the following four conditions:

1. The vehicle is properly registered in another state;
2. The owner is a resident of the state in which the vehicle is registered;
3. The vehicle is used only for the owners' personal transportation; and
4. The vehicle is subject to all other provisions of law applicable to vehicles owned by Minnesota residents.

This provision was enacted in 1967 and was last changed in 1981.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

17.04 MEDAL OF HONOR RECIPIENTS

Minnesota Statutes, Section 168.124

Definition
Medal of honor recipients may obtain license plates which have a special design and the inscription "Medal of Honor" on them. The recipient is issued these plates as well as all subsequent tabs, stickers, or replacement plates free of any charges or tax.

This provision was enacted in 1983 and became effective for calendar year1984.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

17.05 DISABLED VETERANS

Minnesota Statutes, Section 168.031

Definition
Any motor vehicle which has been furnished either free of charge or at reduced cost by the United States government to a disabled war veteran is exempt from the motor vehicle registration tax.

This provision was enacted in 1951 and was last changed in 1971.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

CREDITS

17.06 PHYSICALLY HANDICAPPED PERSONS

Minnesota Statutes, Section 168.021, Subd. 2

Definition
Physically handicapped persons may obtain special license plates bearing the internationally accepted wheelchair symbol. Although these plates are subject to the full motor vehicle registration tax, a one dollar credit is allowed for each month the vehicle is registered.

This provision was enacted in 1975 and last changed in 1976.

Fiscal Impact

FY 1984	Minimal
FY 1985	Minimal
FY 1986	Minimal
FY 1987	Minimal

APPENDIX

A number of provisions in Minnesota tax law appear to be tax expenditures, but they are not considered tax expenditures within the context of this report. Because these provisions are conceptually similar to tax expenditures, they are included here with an explanation. The following lists of provisions are not intended to be exhaustive but rather are representative of provisions which met some but not all of the criteria for a tax expenditure. The provisions are divided into three categories according to the reason they were excluded from the study: (1) In-lieu-of provisions; (2) Provisions which legislative action alone could not repeal; and (3) Provisions which cause no reduction in revenues. The three categories are explained below. A fourth list includes taxes which contain no tax expenditure provisions.

In-lieu-of provisions are those which exempt income, goods or other taxable entities from a tax because another tax is levied in its place. In-lieu-of taxes are generally not intended to provide preferential treatment or benefit to a subset of taxpayers. Often they are imposed for administrative or tax simplification purposes.

Provisions which legislative action alone could not repeal are created when an authority higher than the Minnesota Statutes prohibits some form of taxation. These higher authorities are the Minnesota Constitution, federal law and treaties, and the U.S. Constitution.

The tax provisions that would be tax expenditures except for the fact that they do not cause a reduction in revenues can be separated into three types. The first type is those which may be called potential tax expenditures. These are provisions which would cause a fiscal impact if utilized, but no taxpayers are known to be currently using them.

The second type includes provisions which are the result of reciprocal agreements with other states. These provisions, which may or may not contain compensatory payments from one state to the other, are generally not intended to cause a revenue loss or gain for the states involved, nor is their intention to create preferential treatment for a group of taxpayers.

The third type allows proportional payment of a tax. With these provisions taxpayers are, for example, allowed to apportion tax payments to several states based on some measure of the tax base which is assignable to each state. Again, this is typically done for administrative purposes and not to provide preferential treatment. It should be noted that it would require extensive study in order to make accurate generalizations about the revenue effects of provisions described as being type two or three.

Finally, there is a list of Minnesota taxes which contain no tax expenditure provisions. Tax expenditures are absent from these taxes for two reasons: (1) the tax currently does not apply to any taxpayers; or (2) no taxpayers subject to the tax currently receive preferential treatment within the definition of a tax expenditure.

IN-LIEU-OF PROVISIONS

— Petroleum products subject to the motor fuels excise tax are exempt from the general sales and use tax. M.S., Section 297A.25, Subd. 1(f).

— Central office telephone equipment is exempt from the general sales and use tax due to the gross earnings tax on telephone companies. M.S., Section 297A.25, Subd. 1(n).

— The sale of railroad rolling stock is exempt from the sales and use tax due to the gross earnings tax on railroads, freight line companies, and others. M.S., Section 297A.25, Subd. 1(l).

— The sale of airflight equipment is exempt from the general sales and use tax due to the airflight property tax. M.S., Section 297A.25, Subd. 1(m).

— The sale of mill liners and grinding rods and balls used in the production of taconite is exempt from the general sales and use tax due to occupation taxes. M.S., Section 297A.25, Subd. 1(o).

— Corporations, individuals and others engaged in mining or producing ores which are subject to occupation taxes are exempt from income taxes. M.S., Section 290.05, Subd. 1(a).

PROVISIONS WHICH LEGISLATIVE ACTION ALONE COULD NOT REPEAL

- Benefits received under the railroad retirement act of 1935 are exempt from state taxation due to a federal prohibition. 45 U.S.C. 228.
- Some shipping companies involved in interstate or foreign commerce are excluded from income taxes because of federal law. I.R.C., Section 883(a)(1).
- Interest from U.S. bonds are excluded from individual income and estate taxes because of federal law. I.R.S., Revenue Ruling 69-489.
- Sales of intoxicating liquors for shipment outside the state are exempt from the excise tax because of U.S. constitutional restrictions.

PROVISIONS WHICH CAUSE NO REVENUE REDUCTION TO THE STATE

- A unitary differential credit may be claimed against income tax for businesses meeting certain requirements. M.S., Section 290.06, Subd. 15.
- A credit against income taxes may be claimed for copper-nickel occupation tax paid. M.S., Section 290.082.
- Military pay of servicemen while in MIA status is excluded from estate tax. M.S., Section 291.05(3).
- Motor carriers engaged in interstate commerce may pay sales and use taxes to Minnesota based on the amount of sales and use apportioned to Minnesota. M.S., Section 297A.211.
- Purchases made in the construction of new distillery facilities are exempt from the general sales and use tax. M.S., Section 297.254.
- Common carriers may pay the intoxicating liquors tax to Minnesota based on the amount of sales apportioned to Minnesota. M.S., Section 340.485.
- Intoxicating liquors tax is refunded to retailers for destroyed liquor. M.S., Section 340.485, Subd. 1.
- Petroleum substitutes manufactured from certain waste products are exempt from the motor fuels excise tax. M.S., Section 296.03.
- Sales of cigarettes to foreign ocean-going vessels are exempt from cigarette excise tax. M.S., Section 297.03, Subd. 11.
- Telephone companies may take a deduction from gross earnings tax for switching charges and connecting fees. M.S., Section 295.34, Subd. 1.

TAXES WHICH CONTAIN NO TAX EXPENDITURE PROVISIONS

— Hazardous Waste Generator Tax. M.S., Chapter 115.

— Telegraph Companies Gross Earnings Tax. M.S., Chapter 295.

— Taconite Railroad Gross Earnings Tax. M.S., Chapter 294.

— Express Companies Gross Earnings Tax. M.S., Chapter 295.

— Freight Line Companies Gross Earnings Tax. M.S., Chapter 295.

— Sleeping Car Companies Gross Earnings Tax. M.S., Chapter 295.

— Rural Electric Cooperative Membership Tax. M.S., Chapter 273.

— Surplus Line Insurance Premiums Tax. M.S., Chapter 60A.

— Pari-Mutuel Betting Tax. M.S., Chapter 240.

— Charitable Gambling Tax. M.S., Chapter 349.

— Copper-Nickel Occupation Tax. M.S., Chapter 298.

— Copper-Nickel Production Tax. M.S., Chapter 298.

— Semi-Taconite Production Tax. M.S., Chapter 298.

— Agglomerating Facilities Production Tax. M.S., Chapter 298.

— Production Tax on Iron Bearing Materials other than Taconite and Semi-Taconite. M.S., Chapter 298.

— Unmined Taconite Tax, M.S., Section 298.26.

— Taconite Tailing Tax. M.S., Section 298.24

— Severed Mineral Interests Tax. M.S., Section 273.13.

— Airflight Property Tax. M.S., Section 270.072.

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