State of Minnesota
Tax Expenditure Budget

Fiscal Years 1993-1995

Minnesota Department of Revenue
Tax Research Division

February 1993

Pursuant to Mn Stat 270.067, sd 2

Questions relating to this report and requests
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STATE OF MINNESOTA

TAX EXPENDITURE BUDGET

FISCAL YEARS 1993 - 1995

A REPORT TO THE 1993 MINNESOTA LEGISLATURE

STATUTORY REQUIREMENT: MINNESOTA STATUTES, SECTION 270.067

Minnesota Department of Revenue
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To the Members of the 1993 Legislature of the State of Minnesota:

It is my pleasure to submit to you the 1993 Minnesota Tax Expenditure Budget, as required by Minnesota Statutes, Section 270.067. The report is designed to facilitate a regular, comprehensive legislative review of state and local tax expenditures which provide preferential tax treatment for certain types of taxpayers or activities. The Tax Expenditure Budget enables the Legislature to review tax expenditures as part of the biennial budget process.

This report contains information essential for evaluating Minnesota's state and local tax system. The information is provided for a better understanding of the current tax system and as a basis for making future tax policy decisions.

Sincerely,

Morris J. Anderson
Commissioner

PREFACE

This report is the fourth tax expenditure budget prepared and submitted as required by Minnesota Statutes, Section 270.067 (Appendix A). It reflects Minnesota law as it existed after the 1992 legislative session.

The tax expenditure budget covers all state taxes and all local taxes that are applied statewide. Fees are not included. Only taxes that contain tax expenditure provisions are in the main body of the report. Appendix B lists the taxes that are not currently applicable, and Appendix C lists the taxes which do not contain any tax expenditure provisions.

The main purpose of the tax expenditure budget is to provide information on which sound policy decisions can be made. However, the report contains a large amount of information, and it can be used for various purposes. For example, the report can be used to simply look up the revenue loss of one or more provisions, or it can be used as a reference source for descriptive information on a provision or a tax, including history .

An essential starting point for using the information in this report is the main introduction, beginning on page 1. The main introduction describes the conceptual basis for determining whether a provision is a tax expenditure and also explains how the fiscal impact of a tax expenditure provision is measured.

Following the main introduction is a summary list which contains the name, item number, and fiscal impact of each tax expenditure provision. An item number is assigned to each tax expenditure provision, and the provisions are numbered consecutively within each tax. The item number is the key used to identify and locate provisions throughout this report.

The main body of the report is organized into chapters, with one chapter for each tax. Each chapter contains descriptive information on the tax and detailed information on each tax expenditure provision in that tax. Tax expenditure estimates are provided for fiscal years 1993, 1994, and 1995.

The last section of the report is the topical index, which can be used to help locate a provision or to see how a topic may be addressed in more than one provision or across taxes.

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INTRODUCTION TO THE TAX EXPENDITURE BUDGET

The term "tax expenditure" may appear to be a contradiction. "Tax" means money coming into the government; "expenditure" means money going out. How can money be coming in and going out at the same time?

With a tax expenditure, the money does not come in and then go out again; it does not come in at all. The reason it does not come in is that the law has provided for an exemption, deduction, credit, reduced rate, or other mechanism which lowers the amount of tax revenue that would otherwise be collected.

A tax expenditure is like a direct expenditure in that it can be used to accomplish public policy goals. A tax expenditure may be enacted either to encourage a certain activity or to limit the tax burden on taxpayers in a certain situation.

For example, government can encourage home ownership by providing grants or other assistance to homeowners and, in fact, does facilitate home buying through its financing programs. Home ownership is also encouraged or subsidized through tax expenditures - the itemized deductions for property taxes and home mortgage interest.

A tax expenditure is different from a direct expenditure in that it does not need to be re-enacted. Unless a sunset date is placed on a tax expenditure provision, it could continue indefinitely, whereas direct expenditures must be appropriated for each budget period.

Not only does a tax expenditure not require re-enactment, its fiscal impact is not usually reviewed after it becomes law. When net revenues are forecast, most tax expenditures have already been excluded from the base. Typically, the fiscal impact of an existing provision is not estimated unless a proposal is made to change or repeal it.

The tax expenditure budget provides this information that is not part of the regular budget so that all aspects of government programs can be reviewed. For each provision in the comprehensive list of tax expenditures there is the legal citation, explanation, history, and estimates of the impact of the provision on tax revenues for fiscal years 1993 through 1995.

The purpose of this tax expenditure budget is to provide information. No conclusions are drawn nor are recommendations made regarding whether a provision should be continued, repealed, expanded, or restricted.

Minnesota Statutes, Section 270.067 (reprinted in Appendix A) was enacted in 1983 and requires a tax expenditure budget to be submitted as a supplement to the governor's biennial budget. Prior to this report, tax expenditure budgets were submitted in 1985, 1987, and 1989.

The law was changed in 1989 to require the report to be prepared every four years instead of biennially, specifying that the next report was due in 1993. Therefore, a report was not prepared for the 1991 Legislature. However, the law was changed in 1991 to again require the report to be prepared biennially.

The preparation of this tax expenditure budget involves more than simply listing every exemption, deduction, credit, etc., that is contained in the tax system. A conceptual framework governs the preparation of the report. Each provision is evaluated not subjectively according to its purpose or effectiveness but objectively against a list of criteria. Every effort is made to eliminate value judgments.

Tax Expenditure Criteria

Seven criteria have been established to evaluate tax expenditure provisions for this report. Some of the criteria are taken directly from the authorizing statute; some are based on concepts used in the preparation of federal tax expenditure reports; and others are based on what is believed to be a logical application of the tax expenditure concept. A provision must meet all the criteria in order to be considered a tax expenditure.

A provision is a tax expenditure if it:

- has an impact on a tax that is applied statewide;
- confers preferential treatment;
- results in reduced tax revenue in the applicable fiscal years;
- is not an appropriation;
- is included in the defined tax base;
- is not subject to an alternative tax; and
- can be amended or repealed by a change in state law alone.

The first four criteria are based on the statute requiring the tax expenditure budget (Appendix A).

The tax expenditure budget is required by statute to include every state tax and every local tax that is applied statewide. For example, local taxes that are imposed by only one municipality or only in some counties are not included in the report.

Preferential treatment is a key concept in determining tax expenditures, and a key word in the authorizing statute is "certain". Minnesota Statutes, Section 270.067, Subd. 6(1) (emphasis added):

> "Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for <u>certain</u> persons, types of income, transactions, or property that results in reduced tax revenue.

If a provision is not preferential, it is not a tax expenditure. For example, the personal exemption for the individual income tax is not preferential because each person receives the same amount of exemption. Likewise, the graduated rate structure of the individual income tax is not a tax expenditure because each taxpayer with the same amount of tax base pays at the same rate.

In the statute quoted above, a requirement is that the provision ". . . results in reduced tax revenue". A provision that would otherwise qualify is not considered a tax expenditure if it is not being used or is not likely to be used during fiscal years 1993 through 1995.

The federal law (Congressional Budget Act of 1974, Public Law 93-344) that requires a list of tax expenditures to be included with the federal budget includes in its definition of tax expenditures ". . . provisions of the Federal tax laws which allow . . . a deferral of liability". Although the Minnesota law does not mention deferral of liability, this concept has been adopted in the preparation of the report.

A deferral of liability involves the time value of money and affects primarily the individual income and corporate franchise taxes. A deferral can result either from postponing the time when income is recognized for tax purposes or from accelerating the deduction of expenses. In the year in which either of these is done, taxable income is lower than it would be otherwise, although an adjustment may be made in a future year. The effect of the deferral of liability is like an interest-free loan for the taxpayer.

Some provisions of tax law are similar to tax expenditures, but they are funded through either a direct or open appropriation. Many of the property tax relief provisions fit this pattern. These provisions are not considered tax expenditures because they are already included in the budget as appropriations.

The tax base for each tax must be clearly defined so that exceptions to that base can be identified. Some tax provisions help to define the base; others are exceptions to the base. The first type are outside the tax base and are not tax expenditures; the second type are part of the tax base and are tax expenditures.

For example, if the tax base were oranges, an exemption for tangerines would not be a tax expenditure because tangerines would be outside the tax base. The exemption for tangerines would help to define the tax base. However, an exemption for seedless oranges would be a tax expenditure because they would be included in the tax base.

The defined base for each tax is explained in the chapter introduction to that tax. The tax base for each tax is the conceptual framework used for this report. The determination of the tax base included a review of the statutes, history of the tax, and other pertinent literature.

In some instances, one tax may be imposed in place of another tax, and it would not be reasonable for a taxpayer or activity to be subject to both taxes. Therefore, the exemption from one tax is not considered a tax expenditure if the alternative tax is imposed.

The application of the alternative tax concept for this report was limited to these situations:

- The purchase of a motor vehicle is subject to the motor vehicle excise tax in lieu of the general sales and use tax.
- A motor vehicle using propane, compressed natural gas, or other alternate fuel pays an annual fee in lieu of the per-gallon excise tax on highway fuels.
- A number of taxes are imposed in lieu of the general property tax, including the motor vehicle registration tax and the taconite production tax.
- Noncommercial aircraft are taxed under the aircraft registration tax, whereas commercial airflight property is taxed under the airflight property tax.

However, if a taxpayer can elect to be taxed under an alternative tax that is lower, then the alternative tax provision is considered to be a tax expenditure, measured as the difference between the two taxes. The election to be taxed under the tree growth tax rather than the general property tax is an example of an alternative tax that is preferential (Item 13.05).

The biennial budget contains only items which can become law upon passage by both houses of the Minnesota Legislature and approval by the governor. Likewise, the tax expenditure budget contains only items which can be changed or repealed by the concurring actions of the Legislature and the governor. Provisions that are contained in the Minnesota Constitution, federal law, or the United States Constitution are not within the sole jurisdiction of the governor and the Minnesota Legislature and, therefore, are not included in the tax expenditure budget.

Measuring the Fiscal Impact of Tax Expenditures

The fiscal impact of a tax expenditure is intended to measure what is being "spent" through the tax system on that one provision. It is not the amount of revenue that would be gained by repeal. This distinction is important.

For the tax expenditure budget, each provision is estimated in isolation, and other provisions in that tax and in other taxes are held constant. The secondary impact of one provision on another provision is not taken into account. Because the estimates measure the impact of the provision as it exists and not what would happen if it were repealed, no change in taxpayer behavior is assumed.

In contrast to the tax expenditure estimates, estimating the repeal of a provision would take into account interactions within a tax or between taxes and changes in taxpayer behavior. If two or more provisions in a tax were repealed at the same time, the combined impact of repealing the provisions would be estimated, rather than estimating each provision separately.

The methodology used to estimate tax expenditures can produce misleading results if the estimates for two or more provisions are combined. Depending upon the situation, the combined impact of two or more provisions could be more or less than the total of the provisions estimated separately.

When two or more tax expenditures in a tax overlap, it is important to understand how this situation is treated in the tax expenditure estimates. When one provision is estimated, all other provisions are held constant, meaning that they are assumed to remain unchanged.

For example, when an exemption of a particular product from the sales tax is estimated, sales to exempt purchasers are assumed to remain exempt and are excluded from the estimates. Likewise, when the exemption from the sales tax for a particular purchaser is estimated, the estimates exclude goods and services covered by other exemptions. Therefore, the purchase of an exempt item by an exempt entity is not reflected in either of the estimates. If the two exemptions were repealed together, the estimate of repeal would include the overlap and would therefore be larger than the sum of the two exemptions estimated separately.

The precision of the estimates varies with the source of the data and with the applicability of the data to the tax expenditure provision. Data from Minnesota tax returns were used whenever possible. Other sources included federal tax expenditure estimates, data from federal tax returns, and other data for Minnesota and the nation.

TAX EXPENDITURE SUMMARY LIST

	Fiscal Year Impact 1993	1994	1995
INDIVIDUAL INCOME TAX			
Federal Exclusions			
1.01 Employer-Provided Meals and Lodging	$2,900,000	$2,900,000	$2,900,000
1.02 Rental Value of Parsonages	1,100,000	1,100,000	1,100,000
1.03 Employer-Provided Dependent Care	3,100,000	3,700,000	4,300,000
1.04 Employee Awards	700,000	700,000	700,000
1.05 Employer Pension Plans	284,300,000	296,000,000	308,700,000
1.06 Contributions by Employers for Medical Insurance Premiums and Medical Care	255,800,000	289,500,000	321,000,000
1.07 Employer-Paid Accident and Disability Premiums	700,000	700,000	700,000
1.08 Employer-Paid Death Benefits	100,000	200,000	200,000
1.09 Employer-Paid Group Term Life Insurance Premiums	12,900,000	13,900,000	14,700,000
1.10 Cafeteria Plans	14,100,000	15,300,000	15,900,000
1.11 Employee Fringe Benefits (Other than Provisions Covered in Items 1.01 through 1.10)	24,200,000	25,700,000	27,400,000
1.12 Income Earned Abroad by U.S. Citizens and Foreign Housing Costs	7,400,000	7,700,000	7,900,000
1.13 Benefits and Allowances to Armed Forces Personnel	6,200,000	6,200,000	6,300,000
1.14 Veterans' Benefits	16,700,000	17,200,000	17,700,000
1.15 Military Disability Pensions	300,000	300,000	300,000
1.16 Workers' Compensation Benefits	40,300,000	41,700,000	43,100,000

		Fiscal Year Impact		
		1993	1994	1995
1.17	Special Benefits for Disabled Coal Miners	*	*	*
1.18	Social Security Benefits	$134,300,000	$141,600,000	$148,500,000
1.19	Medicare Benefits	66,700,000	73,900,000	82,500,000
1.20	Foster Care Payments	200,000	200,000	200,000
1.21	Public Assistance	3,500,000	3,700,000	3,900,000
1.22	Scholarship and Fellowship Income	3,500,000	3,900,000	4,200,000
1.23	Certain Agricultural Cost-Sharing Payments	600,000	600,000	600,000
1.24	Discharge of Indebtedness Income for Certain Farmers	3,900,000	3,900,000	2,000,000
1.25	Interest on Life Insurance and Annuity Savings	45,600,000	51,300,000	56,300,000
1.26	Interest on General Obligation State and Local Government Bonds	15,900,000	16,400,000	16,900,000
1.27	Interest on Nonguaranteed State and Local Government Bonds	26,000,000	26,800,000	27,700,000
1.28	Special Treatment of Capital Gains on Home Sales	99,500,000	104,000,000	109,000,000
1.29	Capital Gains at Death	39,800,000	43,500,000	48,000,000
1.30	Capital Gains on Gifts	6,500,000	7,000,000	7,000,000
1.31	Permanent Exemptions from Imputed Interest Rules	1,100,000	1,100,000	1,100,000
1.32	Like-Kind Exchanges	1,000,000	1,000,000	1,000,000
1.33	Special Rules for Magazine, Paperback, and Record Returns	*	*	*

*Less than $50,000

	Fiscal Year Impact		
	1993	1994	1995
Federal Deductions			
1.34 Depreciation	$64,200,000	$66,200,000	$69,100,000
1.35 Expensing Depreciable Business Property	600,000	600,000	600,000
1.36 Excess of Percentage Over Cost Depletion	200,000	200,000	200,000
1.37 Five-Year Amortization of Business Organizational and Start-Up Costs	900,000	1,000,000	1,000,000
1.38 Seven-Year Amortization of Reforestation Expenditures	100,000	100,000	100,000
1.39 Expensing of Research and Development Costs	200,000	200,000	200,000
1.40 Expensing of Magazine Circulation Expenditures	*	*	*
1.41 Expensing for Removal of Barriers to the Handicapped and Elderly	100,000	100,000	100,000
1.42 Expensing of Exploration and Development Costs	*	*	*
1.43 Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	6,300,000	6,300,000	6,300,000
1.44 Expensing of Multiperiod Agricultural Production Costs	1,400,000	1,400,000	1,400,000
1.45 Expensing of Multiperiod Timber Growing Costs	100,000	100,000	100,000
1.46 Special Rules for Mining and Solid Waste Reclamation Reserves	*	*	*
1.47 Cash Accounting Other than Agriculture	200,000	200,000	200,000
1.48 Installment Sales	100,000	100,000	100,000

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
1.49 Individual Retirement Accounts	$48,700,000	$50,700,000	$52,100,000
1.50 Keogh Plans	14,700,000	15,700,000	16,800,000
1.51 Per Diem Amounts Paid to State Legislators	*	*	*
Federal Personal Deductions			
1.52 Additional Standard Deduction for the Elderly and Blind	7,700,000	7,800,000	8,500,000
1.53 Medical and Dental Expenses	15,800,000	19,400,000	20,300,000
1.54 Real Estate Taxes	61,900,000	68,900,000	72,300,000
1.55 Other Taxes	7,000,000	7,900,000	8,300,000
1.56 Interest on Home Mortgages	231,700,000	255,800,000	270,100,000
1.57 Charitable Contributions	72,500,000	77,400,000	81,100,000
1.58 Casualty and Theft Losses	2,500,000	2,600,000	2,600,000
Minnesota Subtractions			
1.59 Education Expenses for Dependent Children	3,000,000	3,000,000	3,100,000
1.60 Income of the Elderly or Disabled	4,500,000	4,500,000	4,500,000
1.61 Payments by the Self-Employed for Health Insurance	4,500,000	10,900,000	11,500,000
1.62 Disposition of Farm Property	100,000	100,000	100,000
Preferential Computation			
1.63 Five-Year Averaging of Lump Sum Distributions	1,300,000	1,300,000	1,300,000
Credits			
1.64 Credit for Income Tax Paid to Other States	21,600,000	23,300,000	25,400,000

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
1.65 Child and Dependent Care Credit	$10,900,000	$11,100,000	$11,400,000
1.66 Working Family Credit	10,900,000	12,000,000	15,500,000
1.67 Construction Financing Credit (Enterprise Zones)	*	*	*
1.68 Employer Tax Credits (Enterprise Zones)	200,000	200,000	100,000

CORPORATE FRANCHISE TAX

Exempt Organizations

	1993	1994	1995
2.01 Credit Unions	2,000,000	2,100,000	2,200,000
2.02 Insurance Companies Domiciled in Retaliatory States	10,000,000	10,000,000	10,000,000
2.03 Smaller Mutual Property and Casualty Insurance Companies	1,000,000	1,000,000	1,000,000

Federal Exclusions

	1993	1994	1995
2.04 Permanent Exemptions from Imputed Interest Rules	*	*	*
2.05 Interest on Life Insurance and Annuity Savings	1,500,000	1,900,000	2,600,000
2.06 Like-Kind Exchanges	1,200,000	1,200,000	1,500,000
2.07 Special Rules for Magazine, Paperback, and Record Returns	100,000	100,000	100,000
2.08 Gains from Sales to Effectuate Policies of the Federal Communications Commission	500,000	500,000	500,000
2.09 Investment Income from Structured Settlement Accounts	*	*	*
2.10 Alternative Computation for Small Property and Casualty Companies	*	*	*

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
Federal Deductions			
2.11 Small Life Insurance Company Deduction	$100,000	$100,000	$100,000
2.12 Depreciation	72,200,000	76,000,000	79,900,000
2.13 Expensing Depreciable Business Property	400,000	400,000	400,000
2.14 Excess of Percentage Over Cost Depletion (Mining Occupation Tax)	1,200,000	1,200,000	1,200,000
2.15 Amortization of Organizational and Start-Up Costs	200,000	200,000	200,000
2.16 Seven-Year Amortization of Reforestation Expenditures	100,000	100,000	100,000
2.17 Expensing of Research and Development Costs	7,900,000	8,300,000	8,400,000
2.18 Expensing of Magazine Circulation Expenditures	100,000	100,000	100,000
2.19 Expensing for Removal of Barriers to the Handicapped and Elderly	500,000	500,000	500,000
2.20 Expensing of Exploration and Development Costs	800,000	1,200,000	1,300,000
2.21 Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	1,700,000	1,700,000	1,700,000
2.22 Expensing of Multiperiod Agricultural Production Costs	600,000	600,000	600,000
2.23 Expensing of Multiperiod Timber Growing Costs	900,000	900,000	1,000,000
2.24 Special Rules for Mining and Solid Waste Reclamation Reserves	100,000	100,000	100,000

	Fiscal Year Impact 1993	1994	1995
2.25 Cash Accounting Other than Agriculture	$200,000	$200,000	$200,000
2.26 Installment Sales	400,000	400,000	400,000
2.27 Patronage Dividends (Cooperatives)	7,000,000	7,300,000	7,600,000
2.28 Excess Bad Debt Reserves of Financial Institutions	600,000	600,000	700,000
2.29 Employee Stock Ownership Plans	4,100,000	4,400,000	4,500,000
2.30 Inventory Property Sales Source Rule Exception	16,100,000	16,800,000	17,300,000
2.31 Capital Construction Funds of Shipping Companies	*	*	*
2.32 Unpaid Property Loss Reserves of Property and Casualty Insurance Companies	800,000	900,000	1,000,000
2.33 Special Treatment of Life Insurance Company Reserves	2,500,000	2,700,000	2,800,000
Apportionment			
2.34 Weighted Apportionment	30,700,000	37,700,000	37,800,000
2.35 Throwback Sales	21,800,000	21,800,000	21,800,000
2.36 Single-Factor Apportionment for Mail Order Companies	2,100,000	2,300,000	2,500,000
Minnesota Subtractions			
2.37 Dividend Received Deduction	30,400,000	37,400,000	37,500,000
2.38 Charitable Contributions	8,600,000	9,100,000	9,500,000
2.39 Foreign Source Income	21,000,000	21,500,000	22,100,000
2.40 Disposition of Farm Property	*	*	*

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
Credits			
2.41 Research and Development Credit	$11,000,000	$11,300,000	$11,700,000
2.42 Construction Financing Credit (Enterprise Zones)	900,000	*	*
2.43 Employer Tax Credits (Enterprise Zones)	700,000	300,000	*
2.44 Credit for Gross Premiums Tax (Insurance Companies)	10,400,000	10,400,000	10,400,000
2.45 Aircraft Maintenance and Engine Repair Facilities Job Credit	0	0	1,300,000
2.46 Designated County Job Credit	0	200,000	0
ESTATE TAX			
Preferential Valuation			
3.01 Special Use Valuation	200,000	200,000	200,000
Exclusions			
3.02 Life Insurance Proceeds	3,900,000	4,200,000	4,500,000
3.03 Annuities	*	*	*
3.04 Social Security Benefits	*	*	*
Deductions			
3.05 Marital Deduction	24,000,000	24,000,000	24,000,000
3.06 Charitable Gifts	5,300,000	5,300,000	5,300,000
SALES AND USE TAX			
Exemptions - Particular Goods and Services			
4.01 Food Products	329,000,000	347,100,000	368,000,000
4.02 Clothing and Wearing Apparel	224,500,000	246,200,000	267,600,000

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
4.03 Drugs and Medicines	$51,300,000	$55,600,000	$60,300,000
4.04 Prescription Eyeglasses	15,300,000	16,300,000	17,500,000
4.05 Therapeutic and Prosthetic Devices	4,500,000	4,900,000	5,400,000
4.06 Baby Care Products	600,000	600,000	700,000
4.07 Feminine Hygiene Items	2,000,000	2,100,000	2,200,000
4.08 Publications	39,000,000	41,200,000	43,800,000
4.09 Motor Fuels	175,000,000	178,400,000	183,600,000
4.10 Petroleum Products Used in the Improvement of Agricultural Land	*	*	*
4.11 Used Motor Oil	100,000	100,000	100,000
4.12 Caskets and Burial Vaults	3,900,000	4,000,000	4,000,000
4.13 Accessory Tools	14,000,000	14,500,000	14,900,000
4.14 Construction Materials or Equipment (Enterprise Zones)	200,000	*	*
4.15 Repair and Replacement Parts for Farm Machinery	6,000,000	6,200,000	6,400,000
4.16 Personal Property Brought into Minnesota	6,700,000	6,800,000	7,100,000
4.17 Packing Materials	*	*	*
4.18 Property for Business Use Outside Minnesota	*	*	*
4.19 Advertising Materials	1,000,000	1,000,000	1,000,000
4.20 Resource Recovery Equipment	300,000	400,000	4,800,000
4.21 YMCA and YWCA Membership Dues	900,000	900,000	900,000
4.22 Cross Country Ski Passes	*	*	*
4.23 Services	1,316,100,000	1,426,300,000	1,540,900,000

*Less than $50,000

		Fiscal Year Impact		
		1993	1994	1995
4.24	Sewer Services	$23,300,000	$24,100,000	$25,100,000
4.25	Residential Water Services	13,300,000	13,900,000	14,400,000
4.26	Residential Heating Fuels	79,500,000	85,500,000	91,500,000
4.27	Certain Interstate Telephone Service	2,600,000	2,700,000	2,900,000
4.28	Used Manufactured Homes	600,000	600,000	600,000
4.29	Photovoltaic Devices	100,000	100,000	100,000
4.30	Wind Energy Conversion Systems	100,000	200,000	300,000
4.31	Air Cooling Equipment	*	*	1,100,000
4.32	Large Ships	100,000	100,000	100,000
Exemptions - Sales to Particular Groups				
4.33	Certain Sales to Local Governments	40,500,000	42,500,000	44,500,000
4.34	Sales to Nonprofit Organizations	34,700,000	35,800,000	37,000,000
4.35	Sales to Veterans' Organizations	200,000	200,000	200,000
4.36	Capital Equipment Sold to New or Expanding Industries	19,200,000	22,200,000	24,200,000
4.37	Taconite Production Materials	*	*	*
4.38	Airflight Equipment	5,900,000	10,100,000	8,900,000
4.39	Aircraft Facility Materials, Equipment, and Supplies	0	3,300,000	11,100,000
4.40	Repair and Replacement Parts for Ships and Vessels	200,000	200,000	200,000
4.41	Construction Materials for Recycling Facilities	0	800,000	0
4.42	Sales to Farmers for Conservation Programs	800,000	800,000	800,000

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
4.43 Sales of Textbooks to Students	$5,500,000	$6,100,000	$6,800,000
4.44 Sales of Building Materials to Disabled Veterans	*	*	*
4.45 Sales of Chair Lifts, Ramps, and Elevators for Disabled Persons' Homesteads	*	*	*
4.46 Ambulances Leased to Licensed Ambulance Services	*	*	*
Exemptions - Sales by Particular Groups			
4.47 Isolated or Occasional Sales	20,000,000	21,500,000	23,000,000
4.48 Institutional Meals	27,300,000	28,100,000	29,000,000
4.49 Fundraising Sales by Nonprofit Organizations	2,900,000	3,000,000	3,000,000
4.50 Candy Sales by Certain Organizations	*	*	*
4.51 Admission to School-Sponsored Events	600,000	600,000	600,000
4.52 Admission to Artistic Events	1,400,00	1,400,000	1,400,000
4.53 Sacramental Wine	*	*	*
Reduced Rates			
4.54 Two and One-Half Percent Rate for Farm Machinery	17,500,000	17,900,000	18,300,000
4.55 Two and One-Half Percent Rate for Logging Equipment	200,000	200,000	200,000
4.56 Four and One-Half Percent Rate for Special Tooling	900,000	1,000,000	1,000,000
4.57 Tax Paid to Other States	1,200,000	1,200,000	1,200,000

*Less than $50,000

	Fiscal Year Impact		
	1993	1994	1995
Reduced Sales Price			
4.58 Price Reduced by Value of Trade In	$5,800,000	$5,900,000	$6,100,000
4.59 New Manufactured Homes	1,000,000	1,000,000	1,000,000
MOTOR VEHICLE EXCISE TAX			
Exemptions			
5.01 Vehicles Acquired by Inheritance	1,800,000	1,900,000	1,900,000
5.02 Vehicles of Persons Moving into Minnesota	5,300,000	5,600,000	5,800,000
5.03 Transfers Between Joint Owners	1,800,000	1,900,000	1,900,000
5.04 Transfers Between Spouses or Parents and Children	8,300,000	8,600,000	8,900,000
5.05 Transfers in Divorce Proceedings	1,200,000	1,300,000	1,500,000
5.06 Corporate and Partnership Transfers	200,000	200,000	200,000
5.07 Sales to Disabled Veterans	*	*	*
5.08 Vehicles Used in Automotive Training Programs	*	*	*
5.09 Ambulances Purchased by Private Ambulance Services	*	*	*
Reduced Purchase Price			
5.10 Federal Excise Taxes	200,000	200,000	200,000
5.11 Price Reduced by Value of Trade In	41,000,000	42,300,000	43,600,000
5.12 Handicapped-Accessible Modifications	*	*	*

*Less than $50,000

	Fiscal Year Impact		
	1993	1994	1995
Preferential Computations			
5.13 Flat Taxes on Older Cars and Collector Vehicles	$6,400,000	$6,600,000	$6,800,000
Credit			
5.14 Credit for Taxes Paid to Other States	500,000	500,000	500,000
HIGHWAY FUELS EXCISE TAXES			
Exemptions			
6.01 Transit Systems Receiving State Financial Assistance	2,100,000	2,100,000	2,100,000
6.02 Motor Vehicles Not Requiring Registration (Special Fuels)	600,000	600,000	600,000
Credits			
6.03 Gasohol (Other than for Governmental Units or School Transportation)	9,400,000	9,500,000	9,600,000
6.04 Gasohol for Governmental Units and School Transportation	300,000	300,000	300,000
ALCOHOLIC BEVERAGE TAXES			
Exemptions			
7.01 Consumer Purchases Made Out of State	*	*	*
7.02 Home Production and Use (Wine and Beer)	*	*	*
7.03 Sales to Food Processors and Pharmaceutical Firms	*	*	*
7.04 Consumption on Brewery Premises (Beer)	*	*	*

*Less than $50,000

	Fiscal Year Impact		
	1993	1994	1995
7.05 Wine for Tasting and Testing	*	*	*
7.06 Wine for Sacramental Purposes	*	*	*
Credit			
7.07 Small Brewers' Credit (Beer)	$200,000	$200,000	$200,000
CIGARETTE AND TOBACCO TAXES			
Exemption			
8.01 Consumer Purchases Made Out of State	2,000,000	2,100,000	2,100,000
MORTGAGE REGISTRY TAX			
Exemption			
9.01 Certain Persons and Organizations	200,000	200,000	200,000
DEED TRANSFER TAX			
Exemptions			
10.01 Deeds Partitioning Property of Co-Owners	100,000	100,000	100,000
10.02 Deeds of Distribution by Personal Representatives	*	*	*
10.03 Deeds for Cemetery Lots	100,000	100,000	100,000
LAWFUL GAMBLING TAXES			
Exemptions			
11.01 Bingo at Certain Organizations	*	*	*
11.02 Bingo at Fairs and Civic Celebrations	*	*	*
11.03 Infrequent Bingo Occasions	*	*	*

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
11.04 Smaller Raffles	*	*	*
11.05 Raffles by Certain Organizations	$200,000	$200,000	$200,000
11.06 Lawful Gambling Under Certain Conditions	700,000	700,000	700,000
INSURANCE PREMIUMS TAXES			
Exemptions			
12.01 Fraternal Benefit Societies	3,200,000	3,400,000	3,700,000
12.02 Nonprofit Health Service Plan Corporations	16,300,000	18,600,000	21,200,000
12.03 Health Maintenance Organizations	29,300,000	32,800,000	36,800,000
12.04 Farmers' Mutual and Township Mutual Fire Insurance Companies (Fire Marshal Tax)	200,000	200,000	200,000
12.05 Minnesota Comprehensive Health Insurance Plan Premiums	900,000	1,100,000	1,400,000
Reduced Rate			
12.06 Smaller Mutual Property and Casualty Insurance Companies	8,600,000	8,900,000	9,300,000
PROPERTY TAX			
Exemptions			
13.01 Exempt Property	1,042,500,000	1,038,700,000	1,051,000,000
Preferential Valuations			
13.02 Classification System	N/A	N/A	N/A
13.03 Green Acres Treatment of Agricultural Land	6,600,000	7,600,000	8,800,000
13.04 Open Space Property	3,900,000	4,500,000	5,100,000

*Less than $50,000

	Fiscal Year Impact 1993	1994	1995
Preferential Computations			
13.05 Auxiliary Forest Tax and Tree Growth Tax	$1,500,000	$1,500,000	$1,700,000
Credits			
13.06 Taconite Homestead Credit	8,200,000	7,800,000	7,800,000
13.07 Power Line Credit	$100,000	$100,000	$100,000
AIRFLIGHT PROPERTY TAX			
Preferential Computation			
14.01 Commuter Airlines	*	*	*
Preferential Valuations			
14.02 Quiet Aircraft	1,100,000	1,200,000	1,300,000
14.03 Certain Airlines	500,000	500,000	500,000
MOTOR VEHICLE REGISTRATION TAX			
Exemptions			
15.01 Local Government Vehicles	4,300,000	4,400,000	4,500,000
15.02 School Buses	300,000	300,000	300,000
15.03 Nonresident Military Personnel	200,000	200,000	200,000
15.04 Medal of Honor Recipients	*	*	*
15.05 Disabled Veterans	*	*	*
15.06 Nonprofit Charities	*	*	*
15.07 Driver Education Programs at Nonpublic High Schools	*	*	*
15.08 Ambulances Owned by Private Ambulance Services	*	*	*

*Less than $50,000

	Fiscal Year Impact		
	1993	1994	1995
Credit			
15.09 Physically Disabled Persons	$400,000	$400,000	$400,000

AIRCRAFT REGISTRATION TAX

Exemptions			
16.01 Local Government Aircraft	*	*	*
16.02 Civil Air Patrol Aircraft	*	*	*

*Less than $50,000

CHAPTER 1: INDIVIDUAL INCOME TAX

Collections and History

Fiscal year 1992 net collections from the individual income tax were $3.1 billion, which was 42.5% of total state revenue. All revenue from this tax goes into the state general fund.

The State of Minnesota enacted an income tax for both individuals and corporations in 1933, twenty years after the federal income tax had been adopted. The same graduated rate schedule applied to both taxes, and it was divided into $1,000 increments, with the lowest rate at 1% on the first $1,000 of taxable income and the highest rate at 5% on taxable income over $10,000.

Although many changes were made to the individual income tax over the years, the structure of the tax remained basically the same from 1933 to 1985. Major changes were made in two areas in 1985: the joint income of married couples and the deductibility of the federal income tax.

Prior to 1985, one rate schedule applied to all filers, so that the income of each person was treated the same, regardless of marital status. Two-income married couples would usually file separately, even though they filed a joint federal return. In 1985 a married-joint schedule was added, and the election to file jointly or separately was required to be the same as on the federal return. Other provisions were changed to be based on the joint income of the couple rather than on the income of each taxpayer.

A deduction for federal income taxes was allowed from 1933 to 1985 at which time the deduction was made an option, with a schedule of higher tax rates used if federal tax was deducted. In 1987 the deduction for federal income tax was eliminated, as part of another wave of broad changes in the individual income tax.

Whereas the 1985 tax changes involved a significant reduction in individual income tax revenues, the combined effect of the 1987 changes was revenue neutral. Although the 1987 changes to the individual income tax were enacted as a package, with the interactions of the various provisions taken into consideration, the changes can be separated into three areas: federal conformity and simplification; 1986 federal tax reform; and rate structure.

Prior to 1987, federal adjusted gross income was the starting point for the Minnesota tax. Several adjustments were made to federal adjusted gross income, and Minnesota had its own standard deduction and personal credits. Minnesota had its own itemized deductions, but over the years they had been brought into closer conformity with the federal.

In 1987 federal taxable income became the starting point for the Minnesota tax, thereby adopting the federal standard deduction and personal exemptions. Some of the adjustments to income were repealed. Using federal taxable income also continued the trend toward closer conformity to federal itemized deductions, with the exceptions now being adjustments to federal taxable income.

Minnesota also adopted nearly all of the landmark changes contained in the federal Tax Reform Act of 1986, most of which took effect in tax year 1987. The changes included the repeal of the 60% capital gains exclusion, the dividend exclusion, and the sales tax deduction, and also the restriction of deductions for individual retirement account contributions, home mortgage interest, medical expenses, passive losses, and consumer interest.

Both the number of tax brackets and the range of tax rates were reduced dramatically. Prior to 1985 there were twelve tax rates, from 1.6% to 16%. Since 1988 there have been only three tax rates - 6%, 8%, and 8.5%. The top rate went from being ten times the lowest rate to 1.4 times the lowest rate.

Tax Base

One criterion for determining if a provision is a tax expenditure is that it is included in the defined tax base. For this study, the tax base for the individual income tax is defined to be income from all sources less expenses that are reasonable and necessary to generate that income. If an expense is determined to be reasonable and necessary to generate income, it is not considered to be a tax expenditure.

An all-encompassing definition of income would include gifts and bequests. For purposes of this study, gifts and bequests that are voluntary and unconditional are not considered income, and, therefore, their exclusion is not considered a tax expenditure. Payments to which the recipient is entitled due to meeting specified requirements, such as social security, workers compensation, and public assistance, are considered income, and the exclusion of that income is considered a tax expenditure.

Computation of the Tax

The tax expenditures for the individual income tax, as for all other taxes, are shown generally in the order in which they occur in the computation of the tax. The Minnesota individual income tax is computed as follows:

	Income from all sources
minus:	federal exclusions
equals:	federal gross income
minus:	federal deductions
equals:	federal adjusted gross income
minus:	federal standard deduction or itemized deductions
minus:	federal personal exemptions
equals:	federal taxable income
plus:	Minnesota additions
	- non-Minnesota state and municipal bond interest
	- federal itemized deduction for state income taxes
	- capital gains portion of a lump sum distribution
minus:	Minnesota subtractions
	- U.S. bond interest
	- dependent education expenses for taxpayers who itemize
	- income of elderly and disabled (up to specified limits)
	- state income tax refunds included in federal taxable income
	- railroad retirement income
	- gains on farm property sales by insolvent farmers
equals:	Minnesota taxable income
times:	graduated rates of 6%, 8%, and 8.5%
equals:	Minnesota gross tax (alternative minimum tax applicable if larger than the regular tax)

minus:	nonrefundable credits
	- credit for income tax paid to other states
	- alternative minimum tax carryover credit
equals:	Minnesota income tax
minus:	refundable credits
	- dependent care credit
	- working family credit (10% of federal earned income credit)
	- enterprise zone credits
equals:	net individual income tax payable

The computation of the Minnesota individual income tax starts with federal taxable income. The definition of federal taxable income in Minnesota tax law references the Internal Revenue Code as of a specified date. If federal legislation is enacted which affects the computation of federal taxable income, the federal changes are not automatically adopted for state tax purposes. A state law change is required to adopt the federal changes, generally by updating the reference to the Internal Revenue Code. Exclusions and deductions contained in federal tax law which Minnesota has adopted are shown in the report as federal exclusions and federal deductions.

Minnesota has adopted the federal personal exemptions and standard deduction without any modifications. Minnesota also adopts the federal itemized deductions, but two adjustments are made. State income taxes deducted are added back on the Minnesota return, and specified dependent educational expenses are deducted. The estimates for the itemized deductions take into account the incremental benefit of the deduction over the standard deduction for those taxpayers who would lose the benefit of itemizing by the loss of that one deduction.

The tax brackets are increased annually by the increase in the United States Consumer Price Index. The rate schedules for tax year 1992 are as follows:

	6%	8%	8.5%
Married Joint	$1 - $20,960	$20,961 - $83,300	Over $83,300
Married Separate	$1 - $10,480	$10,481 - $41,650	Over $41,650
Single	$1 - $14,340	$14,341 - $47,110	Over $47,110
Head of Household	$1 - $17,660	$17,661 - $70,950	Over $70,950

An alternative minimum tax (AMT) on tax preference items is imposed if it is larger than the regular tax computed from the above rate schedule. The Minnesota AMT is similar to the federal AMT and is 7% of Minnesota alternative minimum taxable income. The benefits to a taxpayer of a number of the deductions shown as tax expenditures are lower because part or all of these items must be added back in computing alternative minimum taxable income.

FEDERAL EXCLUSIONS

1.01 EMPLOYER-PROVIDED MEALS AND LODGING

Internal Revenue Code, Sections 119
Minnesota Statutes, Section 290.01, Subd. 19

Section 119 of the Internal Revenue Code allows an employee to exclude from federal gross income the value of meals and lodging furnished by the employer for the employer's convenience on the business premises. To qualify, the lodging must be required as a condition of employment, such as for a live-in housekeeper or an apartment resident manager. This provision does not cover instances in which an employee is reimbursed by the employer for amounts previously spent on meals and lodging.

These exclusions were first allowed in 1918 by federal regulation. Section 119 was enacted in 1954 and last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$2,900,000	$2,900,000	$2,900,000

1.02 RENTAL VALUE OF PARSONAGES

Internal Revenue Code, Section 107
Minnesota Statutes, Section 290.01, Subd. 19

Section 107 of the Internal Revenue Code provides that the gross income of a minister of the gospel does not include any housing allowance that is part of compensation, whether it is the rental value of a home furnished or a rental or housing allowance paid, to the extent that it is used to rent or provide a home. Ministers receiving cash housing allowances may also claim itemized deductions for mortgage interest and real estate taxes on their residences.

This exclusion was enacted federally in 1921.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,100,000	$1,100,000	$1,100,000

1.03 EMPLOYER-PROVIDED DEPENDENT CARE

Internal Revenue Code, Section 129
Minnesota Statutes, Section 290.01, Subd. 19

Employer-provided dependent care assistance is excluded from the employee's income if the assistance is provided through a formal, written plan. The amount excluded from an employee's income cannot exceed $5,000 during a tax year. The assistance provided may not discriminate in favor of employees who are highly compensated, shareholders, owners, or their dependents.

The amount excluded cannot exceed the employee's earned income; amounts exceeding earned income are taxable.

If the taxpayer makes direct payments for child or dependent care, this exclusion does not apply, but the taxpayer may be eligible for the child and dependent care credit (Item 1.65).

This provision was enacted in 1981 and was last changed in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,100,000	$3,700,000	$4,300,000

1.04 EMPLOYEE AWARDS

Internal Revenue Code, Sections 74(c), 102, and 274(j)
Minnesota Statutes, Section 290.01, Subd. 19

Certain employee awards are excluded from gross income. To qualify, the award must be tangible personal property and must be given for either length of service or safety achievement. Limits on the size of the business deduction taken by the business giving the award determine the size of the award that is excluded. In general, the value of the award must not exceed $400.

The employee awards provision was first enacted in 1962 and was last changed in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$700,000	$700,000	$700,000

1.05 EMPLOYER PENSION PLANS

Internal Revenue Code, Sections 401-407, 410, 415, and 457
Minnesota Statutes, Section 290.01, Subd. 19

All employer contributions to an employee's qualified pension plan are excluded from the employee's federal gross income. The earnings derived from such contributions, as well as those from contributions made by the employee, are also excluded. The employee's contribution is excluded from income for specific types of plans, including 401(k) plans, certain government plans, tax-sheltered annuities, and deferred compensation.

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 show the fiscal impact of excluding current-year pension contributions and earnings from taxable income, net of all taxed pension income which is disbursed in that year.

The federal exclusion was enacted in 1921. Minnesota has allowed this exclusion since 1933 and adopted the federal language in 1961. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$284,300,000	$296,000,000	$308,700,000

1.06 CONTRIBUTIONS BY EMPLOYERS FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

Internal Revenue Code, Sections 105 and 106
Minnesota Statutes, Section 290.01, Subd. 19

An employee may exclude from federal gross income all employer contributions to health insurance plans which provide compensation for sickness and injury. Payments from such plans may be excluded to the extent that they are based on the nature of the injury or illness or the cost of medical care and are not based on the period the employee is absent from work.

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 Internal Revenue Service ruling declared these to be taxable. Section 106 was enacted in 1954 to reverse the 1953 ruling and, therefore, employer contributions to all employee health and accident plans are excludable from an employee's gross income.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$255,800,000	$289,500,000	$321,000,000

1.07 EMPLOYER-PAID ACCIDENT AND DISABILITY PREMIUMS

Internal Revenue Code, Section 106
Minnesota Statutes, Section 290.01, Subd. 19

Premiums paid by an employer to an employee accident and disability plan are excluded from the gross income of the employee.

Section 106 was enacted in 1954 and was last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$700,000	$700,000	$700,000

1.08 EMPLOYER-PAID DEATH BENEFITS

Internal Revenue Code, Section 101(b)
Minnesota Statutes, Section 290.01, Subd. 19

Benefits paid by an employer to a beneficiary upon the death of an employee may be excluded from federal gross income. The exclusion is limited to $5,000 and applies to a lump sum distribution from a profit-sharing plan, employee stock ownership plan, an annuity, or tax-sheltered annuity. It does not apply to a joint or survivor annuity.

This provision was enacted in 1951 and was last changed in 1984.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$200,000	$200,000

1.09 EMPLOYER-PAID GROUP TERM LIFE INSURANCE PREMIUMS

Internal Revenue Code, Section 79
Minnesota Statutes, Section 290.01, Subd. 19

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; premiums for coverage in excess of $50,000 must be included in an employee's gross income. In order for the premiums to qualify for the exclusion, the plan must meet certain requirements including nondiscrimination rules.

In 1920 a federal administrative legal opinion was issued authorizing this exclusion. In 1954, when the Internal Revenue Code was revised, the provision was codified as Section 79 and was last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$12,900,000	$13,900,000	$14,700,000

1.10 CAFETERIA PLANS

Internal Revenue Code, Section 125
Minnesota Statutes, Section 290.01, Subd. 19

Section 125 of the Internal Revenue Code allows an employee to choose to receive a combination of nontaxable fringe benefits or receive all or part of the value of the fringe benefits as taxable compensation. The value of a combination of fringe benefits chosen by the employee is excluded from federal gross income. The nontaxable benefits that may be offered by a plan include the following: group term life insurance; accident or health benefits; dependent care assistance; and 401(k), profit sharing, or stock bonus plans. The plan must meet the nondiscrimination requirements in order for the benefits to be excluded.

This exclusion was first allowed in 1978. In 1987 Minnesota adopted the 1986 federal changes.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$14,100,000	$15,300,000	$15,900,000

1.11 EMPLOYEE FRINGE BENEFITS (OTHER THAN PROVISIONS COVERED IN ITEMS 1.01 THROUGH 1.10)

Internal Revenue Code, Section 132
Minnesota Statutes, Section 290.01, Subd. 19

In addition to the employee benefits covered in Items 1.01 through 1.10, certain other employee benefits may be excluded from gross income. The exempt benefits include: employee discounts, up to specified limits; no-additional-cost service, such as an airline pass for an airline employee for an otherwise empty seat; and de minimis fringe benefits for which the value of the property or service provided is so small as to make accounting for it unreasonable or administratively impractical. Working condition fringe benefits are also excluded from gross income, but most are not considered tax expenditures because they are paid for expenses necessary in earning an income.

Prior to 1984, the status of employee benefits not specifically exempted by statute was uncertain. The Internal Revenue Code's definition of income appeared to include these benefits as taxable income; however, Congress prohibited the Internal Revenue Service from issuing any regulations defining these benefits as taxable income. The status of fringe benefits was made certain through the enactment of Section 132 of the Internal Revenue Code, effective January 1, 1985. Any benefit not specified as exempt by Section 132 or another section of the Internal Revenue Code is now considered taxable compensation.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$24,200,000	$25,700,000	$27,400,000

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

Internal Revenue Code, Sections 911 and 912
Minnesota Statutes, Section 290.01, Subd. 19

A United States citizen or resident whose principal residence is in a foreign country and who is either present overseas for eleven out of twelve consecutive months or is a bona fide resident of a foreign country may exclude from federal gross income the income which is earned in a foreign country up to a maximum of $70,000 per year. This exclusion does not apply to federal employees or members of the Armed Forces.

The taxpayer may also exclude from federal gross income any employer-paid foreign housing costs above a floor amount equal to 16% of step 1 salary at the GS-14 level. A deduction of an equal amount is allowed if the foreign housing costs are paid by the taxpayer.

The combined income and housing exclusion or deduction may not exceed the taxpayer's total foreign earned income for that year.

Income earned abroad by United States citizens was first excluded from federal gross income in 1926. The deduction for foreign housing costs was enacted in 1979. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$7,400,000	$7,700,000	$7,900,000

1.13 BENEFITS AND ALLOWANCES TO ARMED FORCES PERSONNEL

Internal Revenue Code, Sections 112 and 134
Minnesota Statutes, Section 290.01, Subd. 19

Section 112 of the Internal Revenue Code excludes all combat pay for military personnel who serve 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 commissioned officers.

Under Section 134 of the Internal Revenue Code, the value of in-kind meals and quarters given to military personnel is excluded from gross income. Also excluded are certain cash allowances provided in lieu of in-kind benefits.

The exclusion of benefits and allowances to Armed Forces personnel was first enacted in 1942. The exclusion of meals, quarters, and cash allowances was codified in Section 134 as part of the federal Tax Reform Act of 1986 which was adopted by Minnesota in 1987. Previously, this exclusion was authorized by regulation and court decisions. Section 113 which provided an exclusion for mustering-out pay was repealed in 1990.

There are about 21,000 Minnesota residents who are active duty members of the Armed Forces.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$6,200,000	$6,200,000	$6,300,000

1.14 VETERANS' BENEFITS

38 United State Code 3101
Revenue Ruling 72-605
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

All benefits administered by the Veterans Administration (VA) are excluded from a taxpayer's federal gross income. VA 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 (including what is commonly referred to as GI Bill benefits).

Compensation for service-related disability 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 the veteran's income; as income rises, benefits fall. Education and training benefits, including readjustment, rehabilitation, and educational assistance programs, are awarded according to the type of training received, time enrolled in the training program, marital status, and number of dependents.

VA benefits have never been taxed, having first been excluded from federal gross income in 1917.

	Fiscal Year Impact		
	1993	1994	1995
Disability Compensation	$14,700,000	$15,200,000	$15,700,000
Pensions	1,000,000	1,000,000	1,000,000
Education and Training	1,000,000	1,000,000	1,000,000
Total - State General Fund	$16,700,000	$17,200,000	$17,700,000

1.15 MILITARY DISABILITY PENSIONS

Internal Revenue Code, Sections 104(a)(4) and 104(b)
Minnesota Statutes, Section 290.01, Subd. 19

Retired military personnel who have at least a 30% disability may receive a pension from the Department of Defense based on either the number of years in service or their percent disability, whichever would produce a larger pension. The amount of pension which would be awarded to the retiree based on percent disability is excluded from federal gross income.

The exclusion is restricted to qualified pensions. For retirees who entered military service on or before September 24, 1975, qualified pensions include pensions awarded for personal injury and illness resulting from active service in the armed forces of any country. For retirees who entered service after September 24, 1975, only pensions awarded for combat-related injuries qualify.

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

Approximately 1,200 Minnesotans received military disability pensions as of September 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$300,000	$300,000	$300,000

1.16 WORKERS' COMPENSATION BENEFITS

Internal Revenue Code, Section 104
Minnesota Statutes, Section 290.01, Subd. 19

All workers' compensation benefits are excluded from federal gross income. The three basic types of workers' compensation benefits are: 1) payments for medical or rehabilitation expenses; 2) compensation for permanent disabilities; and 3) replacement of lost wages.

Workers' compensation benefits were first excluded from federal taxation in 1918 and from Minnesota taxation in 1933 when the Minnesota individual income tax was enacted.

Currently, about 140,000 Minnesotans receive workers' compensation benefits.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$40,300,000	$41,700,000	$43,100,000

1.17 SPECIAL BENEFITS FOR DISABLED COAL MINERS

Internal Revenue Code, Section 104(a)(1)
30 United States Code 801
Revenue Ruling 72-400
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Benefits provided by certain federal programs to coal miners totally disabled as a result of pneumoconiosis (black lung disease), to widows of coal miners who died as a result of pneumoconiosis, and to their dependents are excluded from federal gross income.

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 Revenue Ruling 72-400 because the benefits are classified as workers' compensation.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

1.18 SOCIAL SECURITY BENEFITS

Internal Revenue Code, Section 86
Minnesota Statutes, Section 290.01, Subd. 19

Some or all of a taxpayer's social security benefits are excluded from gross income. The portion that is included in income is equal to the lesser of a) one-half of the benefits received or b) one-half of the excess over the base amount 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 base amount is $32,000 for a married-joint return and $25,000 for a single filer. The tax expenditure measures the exclusion of nontaxable social security benefits, net of the recovery of previously-taxed employee contributions.

Prior to 1984, social security benefits were not subject to federal or Minnesota income tax. The federal taxation of a portion of social security benefits was enacted in 1983, effective beginning in 1984. In 1985 Minnesota adopted the federal treatment.

	Fiscal Year Impact		
	1993	1994	1995
Retired Workers	$106,300,000	$112,000,000	$117,500,000
Disability Benefits	8,400,000	8,900,000	9,400,000
Benefits for Dependents and Survivors	19,600,000	20,700,000	21,600,000
Total - State General Fund	$134,300,000	$141,600,000	$148,500,000

1.19 MEDICARE BENEFITS

Revenue Rulings 70-217 and 70-341
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Medicare benefits are excluded from the gross income of the recipient. The exclusion applies to benefits paid under both the basic hospital insurance program and the supplemental medical insurance program. The basic Medicare program is financed by a portion of the social security payroll taxes on employees, employers, and the self-employed. The supplemental program is a voluntary program financed through individual premiums and matching federal contributions. The tax expenditure measures the impact of excluding benefits attributable to employer contributions through the payroll tax and federal contributions to the supplemental program; it does not include the recovery of previously-taxed contributions made by the recipient.

Medicare benefits have never been taxed although the exclusion has not been specified in the statutes. Revenue rulings in 1970 upheld the exclusion of these benefits.

In 1990, 380,000 people in Minnesota received medicare benefits.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$66,700,000	$73,900,000	$82,500,000

1.20 FOSTER CARE PAYMENTS

Internal Revenue Code, Section 131
Minnesota Statutes, Section 290.01, Subd. 19

Qualified foster care payments are excluded from the income of the foster care provider. The exclusion is limited to payment for no more than ten qualifying foster children or five qualifying foster adults. The tax expenditure measures the exclusion of income that exceeds expenses.

This provision was first adopted in 1978. Prior to the federal Tax Reform Act of 1986, any foster care payments that exceeded documented expenses were included as income. Beginning with tax year 1986, detailed record keeping is no longer required, and the exclusion is extended to foster care payments made for qualifying adults.

In 1990 there were 15,300 children in foster care in Minnesota. There are 1,600 licensed adult care households.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

1.21 PUBLIC ASSISTANCE

Numerous Revenue Rulings
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Public assistance benefits are excluded from federal gross income. The programs through which benefits are paid include Aid to Families with Dependent Children, General Assistance, Emergency Assistance, Minnesota Supplemental Aid, and Supplemental Security Income.

Although theoretically the tax expenditure includes benefits received both in cash and in kind, the estimates reflect only cash payments. Only a portion of the benefits would be subject to the income tax because the annual income of some recipients would be below the income tax filing requirements.

This exclusion has no direct statutory basis. During the 1930's the Internal Revenue Service issued a series of Revenue Rulings on the definition of federal gross income which explicitly exclude these benefits.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,500,000	$3,700,000	$3,900,000

1.22 SCHOLARSHIP AND FELLOWSHIP INCOME

Internal Revenue Code, Section 117
Minnesota Statutes, Section 290.01, Subd. 19

Section 117 of the Internal Revenue Code excludes from federal gross income scholarships and fellowships given to degree candidates to cover tuition, fees, and related expenses, including books and supplies.

This exclusion was first allowed in 1954. Prior to the federal Tax Reform Act of 1986 which was adopted by Minnesota in 1987, scholarship money to cover room and board and money paid to nondegree students (up to $300 per month) were also excluded.

Approximately 100,000 students receive scholarship or fellowship money that qualifies for the exclusion.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,500,000	$3,900,000	$4,200,000

1.23 CERTAIN AGRICULTURAL COST-SHARING PAYMENTS

Internal Revenue Code, Sections 126 and 1255
Minnesota Statutes, Section 290.01, Subd. 19

Agricultural cost-sharing payments may be excluded from federal gross income if these three conditions are met: the United States Secretary of Agriculture certifies that the payment serves to conserve soil and water resources, improve forests, or provide a habitat for wildlife; the Internal Revenue Service determines that the improvement does not substantially increase the annual income from the property; and the cost-sharing payment is for a capital expense.

Payments from four federal programs and one state program currently qualify for the exclusion. The federal programs are the Agricultural Conservation Program, the Rural Clean Water Program, the Forestry Incentive Program, and the Water Bank Program. The state program is the Minnesota Soil and Water Conservation Program.

No deductions, depreciation, amortization, or depletion may be claimed with respect to any such amount excluded from federal gross income.

This exclusion was enacted in 1978 and was last changed in 1980.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$600,000	$600,000	$600,000

1.24 DISCHARGE OF INDEBTEDNESS INCOME FOR CERTAIN FARMERS

Internal Revenue Code, Sections 108(g) and 1017
Minnesota Statutes, Section 290.01, Subd. 19

As a general rule, the amount of any debt forgiveness must be included in the debtor's gross income. If the debtor is insolvent, however, the income is excluded to the extent of insolvency, and the taxpayer's tax attributes, including basis in property and loss and credit carryovers, must be reduced.

A solvent farmer may be treated as insolvent for purposes of this exclusion if at least 50% of his average annual gross receipts for the previous three years comes from farming. Therefore, a solvent farmer who participates in a loan write-down program does not have a potentially large amount of discharge of indebtedness income added to his taxable income in that year.

The income exclusion for solvent farmers was enacted federally in 1986 and by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,900,000	$3,900,000	$2,000,000

1.25 INTEREST ON LIFE INSURANCE AND ANNUITY SAVINGS

Internal Revenue Code, Sections 72 and 101(a)
Treasury Regulation 1.451-2
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Interest earned on life insurance and annuity savings is not included in the recipient's gross income as it accumulates.

For a life insurance policy the exclusion applies to what is commonly referred to as "inside build-up" of investment income. When the premiums paid by the policyholder exceed the cost of insurance, the excess premiums are invested by the company, and interest is credited to the policy. This interest is excluded from the policyholder's income as it accumulates.

If the policy is surrendered before the death of the policyholder, the excess of the cash surrender value over the premiums paid is included in income. In this situation, the income is deferred rather than excluded.

Policy proceeds paid because of the death of the insured are excluded from the gross income of a beneficiary. The accumulated interest paid to beneficiaries is never taxed.

An annuity is an investment contract sold by a life insurance company in which the owner makes a deposit in either a lump sum or installment payments in exchange for regular payments for a lifetime or for a specified number of years. The interest is not included in the gross income of the owner as it accumulates but is deferred until payments are made from the contract to the annuitant.

These exclusions have been in effect since the income tax laws were enacted in 1933. The last change occurred in 1983.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$45,600,000	$51,300,000	$56,300,000

1.26 INTEREST ON GENERAL OBLIGATION STATE AND LOCAL GOVERNMENT BONDS

Internal Revenue Code, Section 103
Minnesota Statutes, Section 290.01, Subd. 19 and Subd. 19a(1)

Generally, all interest income is included in the taxpayer's federal gross income. However, Section 103 of the Internal Revenue Code allows a taxpayer to exclude from federal gross income interest received or accrued from all state and municipal general obligation bonds. This tax expenditure measures the impact of excluding the interest from bonds which are backed by the full faith and credit of the government which issues them. The impact of the interest exclusion for nonguaranteed bonds is estimated separately in Item 1.27.

In determining the Minnesota individual income tax, this exclusion is disallowed if the interest is derived from bonds of non-Minnesota governmental units. Interest from other states which was excluded from federal income is added back to arrive at Minnesota taxable income. The result is that the exclusion is restricted to interest from bonds issued by the State of Minnesota or by local units of government in Minnesota.

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. In 1987 the adoption by Minnesota of federal taxable income (rather than adjusted gross income) necessitated the recodification of these provisions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	15,900,000	$16,400,000	$16,900,000

1.27 INTEREST ON NONGUARANTEED STATE AND LOCAL GOVERNMENT BONDS

Internal Revenue Code, Sections 103 and 141-150
Minnesota Statutes, Section 290.01, Subd. 19 and 19a

Interest received from nonguaranteed state and local government bonds is excluded from federal gross income. For Minnesota income tax purposes, any interest from non-Minnesota state or local governments is added back to determine Minnesota taxable income. Therefore, the net effect is that the exclusion is restricted to interest from bonds issued by the State of Minnesota or by Minnesota local government units. In contrast to Item 1.26 which shows the impact of the interest exclusion from bonds which are backed by the full faith and credit of the government which issues them, this provision covers the exclusion of interest from nonguaranteed bonds.

The interest exclusion applies to several types of bonds, including exempt facility bonds, small-issue bonds, qualified mortgage bonds, qualified student loan bonds, and qualified redevelopment bonds. Federal law imposes an annual volume limitation by state on the total amount of these bonds that can be issued. The limitation for each state is the greater of $50 per resident or $150 million. Also exempt from taxation but not subject to the overall volume limitation are qualified bonds of 501(c)(3) nonprofit organizations and bonds for government-owned airports, docks, wharves, and certain solid waste disposal facilities. Other limitations apply to certain types of bonds including those subject to and exempt from the overall state volume limitation.

The federal government first excluded interest from all forms of state and local bonds 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. A 1968 federal law restricted the tax-free status given interest of industrial revenue bonds to those issued for specific purposes. In 1984 a federal law was enacted which limits by state the total amount of certain types of state and local bonds which may be issued, and the federal Tax Reform Act of 1986 further limited the amount of tax-exempt bonds by reducing the per capita limitations for the states. In 1987 the adoption by Minnesota of federal taxable income (rather than adjusted gross income) necessitated the recodification of these provisions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$26,000,000	$26,800,000	$27,700,000

1.28 SPECIAL TREATMENT OF CAPITAL GAINS ON HOME SALES

Internal Revenue Code, Sections 121 and 1034
Minnesota Statutes, Section 290.01, Subd. 19

The capital gain from the sale of a taxpayer's principal residence may be deferred or excluded from income if certain conditions are met.

A deferral of the gain from the sale of an owner-occupied home is allowed when the seller buys another home of equal or greater value within two years. The deferred gain reduces the basis of the second home, and the lowered basis will increase the gain realized when the second home is sold unless the seller again qualifies for deferral. There is no limit to the number of home sales from which a taxpayer may defer the gain as long as the specified conditions are met each time.

A once-in-a-lifetime exclusion of up to $125,000 is allowed to a taxpayer age 55 or over on the gain from the sale of a principal residence. This exclusion allows the older taxpayer to move into a less expensive home or into an apartment without being taxed on up to $125,000 of gain from the home's sale. The exclusion could apply to the gain on one home or to the deferred gain from any number of previous homes. In the latter case, a deferral is therefore converted to an exclusion.

Capital gains on home sales excluded at death are included in Item 1.29.

The deferral was enacted in 1951 and the exclusion provision was enacted in 1964. In 1989 the deferral was extended to a surviving spouse, and time spent in a nursing home could be counted as time using the residence.

	Fiscal Year Impact		
	1993	1994	1995
Deferral	$73,800,000	$77,700,000	$81,600,000
Exclusion - Age 55+	25,700,000	26,300,000	27,400,000
Total - State General Fund	$99,500,000	$104,000,000	$109,000,000

1.29 CAPITAL GAINS AT DEATH

Internal Revenue Code, Sections 1001, 1014, 1040, 1221, and 1222
Minnesota Statutes, Section 290.01, Subd. 19

When property is transferred because of the death of the owner, the heir's basis in the property is the value of the asset at the time of the decedent's death rather than the original cost of the asset. Therefore, the appreciation of the asset occurring during the decedent's lifetime is excluded from gross income.

The fiscal impact measures the exclusion against the taxation of the gain at the time of transfer at death.

The exclusion of capital gains at death was enacted federally in 1921. A similar provision was incorporated into the original Minnesota income tax law in 1933.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$39,800,000	$43,500,000	$48,000,000

1.30 CAPITAL GAINS ON GIFTS

Internal Revenue Code, Sections 1001, 1015, 1221, and 1222
Minnesota Statutes, Section 290.01, Subd. 19

The taxation of the capital gain on an asset is deferred when it is given as a gift. The recipient's basis in the property is the same as the giver's basis, but the gain is not reported as income until the property is sold by the recipient. The deferral is considered a tax expenditure because a gain is generally recognized when an asset is transferred.

The provision was enacted federally in 1921 and by Minnesota in 1933.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$6,500,000	$7,000,000	$7,000,000

1.31 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Section 7872
Minnesota Statutes, Section 290.01, Subd. 19

Section 7872 of the Internal Revenue Code contains imputed interest rules designed to prevent the assignment of income through the use of below-market or interest-free loans. When the rules apply, a lender is deemed to have received interest payments, and a borrower is deemed to have paid interest payments. Exempt from the imputed interest rules are loans of less than $10,000 if they are gift loans or if they are compensation related or are corporate-shareholder loans. Also exempt are loans to qualified continuing extended care facilities and certain employee home relocation loans. There is a special method for computing income from a gift loan of less than $100,000.

Imputed interest rules and exemption from the rules were first effective in 1984 and were last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,100,000	$1,100,000	$1,100,000

1.32 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from the sale or exchange of property is recognized as income for tax purposes. However, the gain from a like-kind exchange is not recognized at the time of exchange if both the relinquished and the received property are held for productive use in a trade or business or for investment. The recognition of the gain is deferred until the received property is sold or otherwise disposed. In order for the gain to qualify for deferral, the exchange must be concluded within specified time limits. This provision does not cover stock in trade or other property held primarily for sale, or stock, bonds, notes, or other securities.

Section 1031 was enacted in 1954 and was last amended in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,000,000	$1,000,000	$1,000,000

1.33 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

Internal Revenue Code, Section 458
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer who distributes magazines, paperbacks and sound recordings and who uses the accrual method of accounting may elect to exclude from gross income for the taxable year the income attributable to the qualified sale of any magazine, paperback, or sound recording which is returned to the taxpayer before the end of the merchandise return period, even though the merchandise return period extends into the next taxable year.

A sale of such merchandise is a qualified sale if the merchandise is not resold and the taxpayer has a legal obligation to adjust the sales price if it is not resold. The excludable amount is the amount by which the price is adjusted. Separate rules govern how the excludable income is distributed over time for magazines and for paperbacks and records.

Section 458 of the Internal Revenue Code was enacted in 1978.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

FEDERAL DEDUCTIONS

1.34 DEPRECIATION

Internal Revenue Code, Section 168
Minnesota Statutes, Section 290.01, Subd. 19

A deduction is allowed for the depreciation of machinery, equipment, and structures used in a trade or business or held for the production of income. Beginning generally with property placed in service after December 31, 1986 (with some exceptions), the modified accelerated cost recovery system (MACRS) is used.

Under MACRS, machinery or equipment is classified as either three-, five-, seven-, or ten-year property, and the 200% declining balance method is used. The 150% declining balance method applies to fifteen- and twenty-year property. Straight-line depreciation of 27.5 years is used for residential rental property, and 31.5 years is used for nonresidential real property.

Conceptually, the tax expenditure is the extent to which depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. For machinery and equipment, the tax expenditure is measured as the difference between the current law depreciation schedule and straight-line depreciation over the period defined by the midpoint of the asset depreciation range (ADR) system that was in effect from 1971 to 1981. For structures, it is measured as the difference between current law depreciation and straight-line depreciation over forty years.

A depreciation deduction was part of the original Minnesota income tax enacted 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. In 1987 Minnesota adopted MACRS as it was enacted as part of the federal Tax Reform Act of 1986.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$64,200,000	$66,200,000	$69,100,000

1.35 EXPENSING DEPRECIABLE BUSINESS PROPERTY

Internal Revenue Code, Section 179
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to treat the cost of qualifying business property as an expense and to deduct the cost in the year the property is placed in service. The deduction is taken instead of the depreciation deduction.

The maximum annual deduction is $10,000 for property placed in service after 1986. If the taxpayer places more than $200,000 of qualifying personal property in service during the taxable year, the $10,000 limitation is reduced by one dollar for each dollar that the cost exceeds $200,000. Therefore, no expensing deduction is allowed if the cost exceeds $210,000.

The estimates measure the difference between expensing the property and a depreciation deduction which would reflect the actual useful life of the property.

This provision was adopted in 1982. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$600,000	$600,000	$600,000

1.36 EXCESS OF PERCENTAGE OVER COST DEPLETION

Internal Revenue Code, Sections 611, 612, 613, and 613A
Minnesota Statutes, Section 290.01, Subd. 19

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

A taxpayer may choose from two forms of depletion: cost depletion or percentage depletion. Cost depletion is based on the taxpayer's basis in the property and is similar to depreciation in its application. Percentage depletion 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 in excess of cost depletion is considered a tax expenditure.

A deduction for cost depletion was first allowed in 1913 for the federal income tax, and percentage depletion was first allowed as an option in 1926. A 1986 federal change adopted by Minnesota in 1987 denies the use of percentage depletion for lease bonuses, advance royalties, or other payments that are not directly related to actual production from the property. This restriction applies to oil, gas, and geothermal properties.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

1.37 FIVE-YEAR AMORTIZATION OF BUSINESS ORGANIZATIONAL AND START-UP COSTS

Internal Revenue Code, Sections 195 and 709
Minnesota Statutes, Section 290.01, Subd. 19

Under Section 195 of the Internal Revenue Code, taxpayers who pay or incur business investigatory 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 sixty months, beginning with the month in which the business commences. In addition, Section 709 allows partnerships to similarly amortize organization fees.

Without these special provisions, these expenditures 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.

Section 709 was enacted in 1976, and Section 195 was enacted in 1980. The last change to these provisions took effect in 1984.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$900,000	$1,000,000	$1,000,000

1.38 SEVEN-YEAR AMORTIZATION OF REFORESTATION EXPENDITURES

Internal Revenue Code, Section 194
Minnesota Statutes, Section 290.01, Subd. 19

In general, investment costs such as those a timber grower incurs in clearing land and planting trees are considered capital outlays and may not be deducted from income until the trees are sold. However, timber growers are allowed a special incentive for forestation or reforestation. Up to $10,000 expended in a year for reforestation can be amortized over seven years. Since timber growth periods are typically longer than fifteen years, this provision allows reforestation expenses to be deducted long before the general rule would allow them to be deducted.

This provision was enacted in 1980, and it was last changed in 1982.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

1.39 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174
Minnesota Statutes, Section 290.01, Subd. 19

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. However, a taxpayer may elect to deduct as an expense in the current tax year 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 sixty months.

No substantive changes have been made to this provision since it was adopted in 1955.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

1.40 EXPENSING OF MAGAZINE CIRCULATION EXPENDITURES

Internal Revenue Code, Section 173
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to deduct as an expense in the current year expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical. This treatment is restricted to certain types of expenditures, and the election is binding for the current year and to similar expenditures in subsequent years.

This provision is a tax expenditure because, in general, expenses incurred in creating or developing an asset must be capitalized.

Section 173 of the Internal Revenue Code was enacted in 1950 and was adopted by Minnesota in 1951. It was last changed in 1984.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

1.41 EXPENSING FOR REMOVAL OF BARRIERS TO THE HANDICAPPED AND ELDERLY

Internal Revenue Code, Sections 44(d)(7) and 190
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to expense qualifying barrier removal expenses in the year incurred instead of capitalizing them. To qualify, the removal of barriers must make a facility or public transportation vehicle owned or leased by the taxpayer for use in his trade or business more accessible to and usable by handicapped and elderly persons and must meet standards of the Architectural and Transportation Barriers Compliance Board. The maximum deduction per year is $15,000, and expenses used for the federal disabled access credit for small businesses are not deductible.

This provision was enacted in 1976. In 1990 the maximum deduction was reduced from $35,000 to $15,000, and expenses used for the newly-enacted federal credit were disallowed. These changes were adopted by Minnesota in 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

1.42 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 263(c), 465, 616, 617, and 704(d)
Minnesota Statutes, Section 290.01, Subd. 19

Current year expensing is allowed for items such as labor, fuel, repairs, and site preparation costs in the exploration and development of oil, gas, other fuel, and non-fuel mineral deposits. Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are treated as capital expenses, which increase the taxpayer's basis in the property.

Current year expensing of development costs for oil and gas has been allowed federally 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 Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

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

Internal Revenue Code, Sections 162, 175, 180, 447, 464, 465, and 704(d)
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer engaged in the business of farming may treat certain expenditures made during the tax year as expenses rather than as capital expenditures. Therefore, the expenditures are entirely deductible in the current year. To qualify for this special treatment the expenditures must be for soil and water conservation under a government-approved plan, the purchase and application of fertilizer, or certain preproduction costs. The expensing of capital outlays is a tax expenditure because normally the cost of a capital outlay for land improvement would not be deductible.

Farmers are allowed to use cash accounting rather than the accrual system for income tax purposes. Therefore, costs attributable to goods not yet sold may be deducted in the current year. The accrual system is normally required for businesses with inventories.

Farmers have been allowed to use the cash accounting system for tax purposes since 1933. Minnesota began allowing the expensing of capital outlays in 1955. In 1986 the expensing provision was eliminated for land clearing and was restricted for soil and water conservation expenditures, and Minnesota adopted these federal changes in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$6,300,000	$6,300,000	$6,300,000

1.44 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

Internal Revenue Code, Section 263A(d)
Minnesota Statutes, Section 290.01, Subd. 19

Farmers are allowed to deduct in the current year certain multiperiod production costs rather than follow the general capitalization rules. Expensing is allowed in two types of situations.

Farmers who are allowed to use cash accounting may elect to deduct currently all preproductive costs of animals and also of plants that have a preproductive period of two years or less. These costs must be recaptured as ordinary income upon disposition of the product, and the alternative depreciation system must be used for farm assets placed in service during a year in which the election is in effect. Vintners and orchard growers may expense the costs of replacing plants or trees that have been damaged by disease, pests, frost, or other natural disasters.

Expensing has always been allowed for these types of costs incurred by farmers. However, this provision was enacted as part of the federal Tax Reform Act of 1986 as an exception to the uniform capitalization rules adopted in that same act. This provision was last changed in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,400,000	$1,400,000	$1,400,000

1.45 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

Internal Revenue Code, Section 263A(c)(5)
Minnesota Statutes, Section 290.01, Subd. 19

Timber growers are allowed to deduct in the current year multiperiod production costs rather than following the general capitalization rules. The exception to the capitalization rules applies to the costs incurred in raising, growing, or harvesting trees other than trees bearing fruit, nuts, or other crops, or ornamental trees.

The new capitalization rules were enacted as part of the Tax Reform Act of 1986. Although the expensing of timber growing costs was allowed previously, it is now considered a tax expenditure because the general rules that apply to other business activities are more restrictive. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

1.46 SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION RESERVES

Internal Revenue Code, Section 468
Minnesota Statutes, Section 290.01, Subd. 19

In general, expenses that will be incurred in the future may not be claimed as a current deduction. Under the accrual method of accounting, future expenses can be deducted only when the economic activity giving rise to the expense has occurred.

An exception is provided for mining and solid waste reclamation costs which are incurred in order to comply with a federal, state, or local law, as specified. A deduction may be taken in the current year for the estimated future reclamation or closing costs attributable to production or mining activity during the taxable year. A bookkeeping reserve must be maintained for tax purposes so that, when reclamation or closing costs are actually incurred, they can be compared to the deductions taken. Any excess of the reserve, including interest, over actual costs must be included in income at that time.

Section 468 was enacted in 1984 and was last changed in 1986.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

1.47 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Section 446
Minnesota Statutes, Section 290.01, Subd. 19

Section 446 of the Internal Revenue Code allows a taxpayer to choose the cash method of accounting instead of the accrual method. The accrual method is considered a better measure of current-year income and expenses because it takes into account the income of receivables. This tax expenditure is the difference in net income measured by accrual accounting and cash accounting. Presently, accrual accounting is required for businesses that maintain inventories.

Cash accounting has been permitted since 1933. The Tax Reform Act of 1986 placed some restrictions on the use of cash accounting by partnerships.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

1.48 INSTALLMENT SALES

Internal Revenue Code, Sections 453, 453A and 453B
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain or loss from the sale of property is recognized in the year of the sale. An exception to the above rule is the installment method. The installment method of reporting may be used to report gains if at least one payment is received in a tax year other than the year of sale. Under the installment method, gross profit is prorated over the period in which payments are received. The tax expenditure is the difference between what tax liability would be under year-of-sale reporting and what it is under installment reporting.

The option to use the installment method is generally limited to casual sales of noninventory personal property and certain sales of real property.

The installment method was first enacted in 1933. In 1986 the installment method was eliminated for revolving credit sales of personal property and sales of property regularly traded on an established market, such as stocks or securities. In 1987 the installment method was repealed for dealer sales of both real and personal property. The 1986 and 1987 federal changes were adopted by Minnesota in 1987 and 1988 respectively.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

1.49 INDIVIDUAL RETIREMENT ACCOUNTS

Internal Revenue Code, Sections 219 and 408
Minnesota Statutes, Section 290.01, Subd. 19

An individual may take a deduction for contributions made during the year to an individual retirement account (IRA) up to a maximum of $2,000 or an amount equal to earned income, whichever is less. These maximum amounts apply if neither the taxpayer nor the spouse is a participant in an employer-provided retirement plan.

If the taxpayer or spouse is a participant in an employer plan, the full deduction is allowed if adjusted gross income is $40,000 or less for a married-joint return or $25,000 or less for a single person. The maximum deduction is phased out so that no deduction is allowed for a married-joint return with income of $50,000 or more or for a single person with income of $35,000 or more.

Earnings on IRA funds are not included in income until the funds are distributed. A taxpayer may make nondeductible contributions to an IRA, but the earnings would still be deferred. The sum of deductible and nondeductible contributions for a year cannot exceed the lesser of $2,000 or the amount of earned income.

Disbursements from an IRA are included in the recipient's income except for the recovery of any previously-taxed contributions. Therefore, the IRA provisions are deferrals, measured for a fiscal year as the exclusion of earnings and the deduction for contributions, net of disbursements included in income that year.

The federal IRA provisions were enacted in 1974. In 1981 the contribution deduction was extended to persons covered by employer pension plans. In 1986 restrictions were placed on the deductions allowed for participants in employer plans, and nondeductible contributions were allowed. Minnesota has followed the federal provisions but did not conform to the 1981 federal changes until 1985. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$48,700,000	$50,700,000	$52,100,000

1.50 KEOGH PLANS

Internal Revenue Code, Sections 401-405 and 408-415
Minnesota Statutes, Section 290.01, Subd. 19

A self-employed person may take a deduction for contributions made to a Keogh retirement plan of the lesser of 25% of self-employment income (net of any Keogh contributions) or $30,000. Interest earned is not included in the recipient's income until it is withdrawn from the fund.

A Keogh plan must cover any eligible employees in addition to the owner. The deduction for contributions made on behalf of employees is considered a normal business expense and, therefore, not a tax expenditure.

Disbursements from a Keogh plan are included in the recipient's income except for the recovery of any previously-taxed contributions. Therefore, the Keogh provisions are deferrals, measured for a fiscal year as the exclusion of earnings and the deduction for contributions, net of disbursements included in income that year.

This provision was originally enacted in 1962. From 1982 to 1984 the Minnesota deduction was more restrictive than the federal deduction. In 1985 Minnesota adopted the federally-allowed deduction. The 1986 federal technical changes were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$14,700,000	$15,700,000	$16,800,000

1.51 PER DIEM AMOUNTS PAID TO STATE LEGISLATORS

Internal Revenue Code, Section 162(h)
Minnesota Statutes, Sections 290.01, Subd. 19

State legislators who reside more than fifty miles from the state capitol building are allowed a deduction for per diem allowances received for days that the Legislature is in session and for committee meetings that the legislator is required to attend.

Minnesota enacted a deduction of all per diem allowances for all legislators in 1959, and the full deduction was allowed until the provision was repealed in 1987. The federal deduction became effective in 1976, and the fifty-mile restriction was added in 1981. For the years that both the federal and Minnesota provisions were in effect, any federally-allowed deduction passed through to Minnesota as part of federal adjusted gross income, and any allowance not deductible on the federal return was subtracted on the Minnesota return. Beginning with tax year 1987, Minnesota conforms to the federal treatment and, therefore, disallows the deduction for legislators who reside within fifty miles of the capitol building and for nonqualifying interim per diem.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

FEDERAL PERSONAL DEDUCTIONS

1.52 ADDITIONAL STANDARD DEDUCTION FOR THE ELDERLY AND BLIND

Internal Revenue Code, Section 63(c)(3) and (f)
Minnesota Statutes, Section 290.01, Subd. 19

The elderly (age 65 and over) and the blind are allowed a standard deduction amount in addition to the standard deduction available to other taxpayers. For tax year 1992, the additional standard deduction for married couples is $700 for each person (taxpayer or spouse) who is elderly or

*Less than $50,000

blind ($1,400 if elderly and blind). The additional standard deduction for single and head of household is $900 for a taxpayer who is elderly or blind ($1,800 if elderly and blind). The basic and additional standard deduction amounts are indexed annually.

The tax expenditure measures only the impact of the additional standard deduction allowed to elderly and blind filers. The basic standard deduction available to all taxpayers, including the elderly and blind, is not considered a tax expenditure because equal amounts are allowed to similarly-situated taxpayers.

From 1951 through 1986 Minnesota allowed to the elderly and the blind an additional personal credit against the tax, with an additional credit for the deaf enacted in 1975 and for the quadriplegic in 1979. Prior to tax year 1987, an additional personal exemption was allowed to the elderly and the blind on the federal return. The additional standard deduction was enacted as part of the federal Tax Reform Act of 1986 and was adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$7,700,000	$7,800,000	$8,500,000

1.53 MEDICAL AND DENTAL EXPENSES

Internal Revenue Code, Sections 63(d) and 213
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for unreimbursed medical expenses paid by an individual to the extent they exceed 7.5% of federal adjusted gross income. Deductible expenses include health insurance premiums, medical care, dental care, prescription drugs, insulin, necessary transportation, and lodging away from home essential to medical care.

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. In 1987 Minnesota adopted the 1986 federal change which increased the floor for the deduction from 5% to 7.5% of federal adjusted gross income. In 1991 Minnesota adopted the federal change which disallowed the deduction for cosmetic surgery, with specified exceptions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$15,800,000	$19,400,000	$20,300,000

1.54 REAL ESTATE TAXES

Internal Revenue Code, Sections 63(d) and 164
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for real estate taxes paid during the taxable year. The deduction is reduced by any Minnesota property tax refund received. Special assessments are not considered real estate taxes and cannot be deducted. For tax years 1991 through 1995 this deduction is one of several deductions subject to the phaseout of itemized deductions for higher-income taxpayers.

Business or trade-related real estate taxes are not included in the estimates. Although they may be deducted in arriving at taxable income, they are not considered tax expenditures because they are costs necessary for earning income.

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. The provision was recodified in 1987. In 1991 Minnesota adopted the federal phaseout of certain itemized deductions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$61,900,000	$68,900,000	$72,300,000

1.55 OTHER TAXES

Internal Revenue Code, Sections 63(d) and 164
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for specified taxes besides the real estate tax paid during the tax year, including personal property taxes and foreign income tax.

The ad valorem portion of the motor vehicle registration tax is deductible under these provisions and accounts for most of the deduction. (The motor vehicle registration tax is explained in Chapter 15.) Also deductible would be the personal property taxes paid on a mobile home owned by the taxpayer but situated on a lot that was rented.

This deduction was enacted in 1933. It was last changed in 1983 and was recodified in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$7,000,000	$7,900,000	$8,300,000

1.56 INTEREST ON HOME MORTGAGES

Internal Revenue Code, Sections 63(d) and 163
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may take an itemized deduction for interest on debt secured by a principal or second residence. Although certain restrictions apply, most taxpayers can deduct the full amount of their mortgage or contract-for-deed interest. For tax years 1991 through 1995 this deduction is one of several deductions subject to the phaseout of itemized deductions for higher-income taxpayers.

For a debt incurred after October 13, 1987, mortgage interest is deductible on up to $1 million of debt used to buy, build, or improve a principal or second residence. If the debt is used for any other purpose, the limitation is $100,000 of debt. Home equity loans fall into this second category and are subject to the $100,000 debt limitation. If more than one home is involved, the limitations apply to the total amount of the mortgages.

Home mortgage interest was deductible without limitation for tax years 1933 through 1986. The current restrictions were enacted federally in 1987 and by Minnesota in 1988. In 1991 Minnesota adopted the federal phaseout of certain itemized deductions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$231,700,000	$255,800,000	$270,100,000

1.57 CHARITABLE CONTRIBUTIONS

Internal Revenue Code, Sections 63(d) and 170
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for contributions to organizations that are religious, charitable, educational, scientific, or literary in purpose. In general, the deduction is limited to a maximum of 50% of federal adjusted gross income, although other limitations apply to specific types of contributions. Excess contributions may be carried forward for up to five years. For tax years 1991 through 1995 this deduction is one of several deductions subject to the phaseout of itemized deductions for higher-income taxpayers.

A deduction for charitable contributions has been allowed since the Minnesota income tax was enacted in 1933. Until 1985, the deduction differed from the federally-allowed deduction, mainly in regard to the maximum deduction and carry forward provision. In 1985 Minnesota adopted the federal deduction. A 1986 federal change adopted by Minnesota in 1987 placed some restrictions on travel expenses that are allowed as deductible charitable contributions. In 1991 Minnesota adopted the federal phaseout of certain itemized deductions.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$72,500,000	$77,400,000	$81,100,000

1.58 CASUALTY AND THEFT LOSSES

Internal Revenue Code, Sections 63(d) and 165
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for nonbusiness losses caused by theft, vandalism, fire, storm, and car, boat, and other accidents. The deduction is allowed only to the extent that each separate casualty or theft loss exceeds $100 and the total of all net losses during the year exceeds 10% of federal adjusted gross income. If the loss is covered by insurance, a timely insurance claim must be filed.

A deduction for casualty or theft loss was first authorized for the federal income tax in 1913 and for the state tax in 1933. The 1986 federal change to this provision requiring a timely insurance claim to be filed was adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$2,500,000	$2,600,000	$2,600,000

MINNESOTA SUBTRACTIONS

1.59 EDUCATION EXPENSES FOR DEPENDENT CHILDREN

Minnesota Statutes, Section 290.01, Subd. 19b(3)

A Minnesota resident may deduct certain education expenses for dependent children in public or private school. Qualifying expenses include those for tuition, transportation, and non-religious textbooks or supplies required for a subject commonly taught in the public schools. The maximum deduction is $650 per child in kindergarten through sixth grade and $1,000 per child in seventh through twelfth grades.

This deduction can be taken only if the taxpayer itemizes deductions on the federal return. It is the only itemized deduction that Minnesota allows that is in addition to the federal itemized deductions.

This deduction has been allowed since 1955. From 1971 through 1973 Minnesota also provided a credit for tuition paid to private schools, but the credit was declared unconstitutional and repealed. In 1983 the United States Supreme Court ruled the deduction constitutional. The current maximum amounts were enacted in 1984. The provision was recodified in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,000,000	$3,000,000	$3,100,000

1.60 INCOME OF THE ELDERLY OR DISABLED

Minnesota Statutes, Sections 290.01, Subd. 19b(5) and 290.0802

A subtraction is allowed from federal taxable income for persons who are elderly (age 65 or over) or totally disabled. Taxpayers eligible for the subtraction are generally those with low income from pension and interest who receive relatively small amounts of nontaxable income, such as social security.

The subtraction is allowed against any type of taxable income, not just pensions, and is computed as follows for a married couple who both qualify as elderly or disabled and file a joint return: $10,000 minus nontaxable retirement and social security benefits minus one-half of federal adjusted gross income over $15,000.

The $10,000 and $15,000 amounts used in the above computation are different for the other filers types, as follows: $10,000 and $12,000 for a married-joint return if only one spouse qualifies; $8,000 and $12,000 for a single person; and $5,000 and $7,500 for a married-separate return. A married couple must file a joint return to claim the subtraction unless the spouses live apart the entire year.

This subtraction was enacted in 1988 and was last changed in 1989. From the beginning of the state income tax, Minnesota has provided some form of tax relief for retired, elderly, or disabled persons. Public pensions were exempt from the Minnesota income tax from 1933 through 1977. From 1978 through 1986 a subtraction was allowed, in various forms, for public or private pension income, limited to a maximum amount with qualifying offsets or reductions. For tax year 1987 only, a credit against the tax was allowed which was equal to 40% of the federal credit for the elderly and disabled.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$4,500,000	$4,500,000	$4,500,000

1.61 PAYMENTS BY THE SELF-EMPLOYED FOR HEALTH INSURANCE

Minnesota Statutes, Sections 290.01, Subd. 19b(8)

A self-employed individual is allowed a subtraction from federal taxable income for the amount paid for health insurance premiums for the taxpayer, spouse, and dependents. The subtraction is allowed only to the extent that the premiums have not been deducted in determining federal taxable income. If the health insurance premiums were subtracted as an itemized medical deduction, the subtraction is reduced.

Federally, a deduction was allowed to self-employed individuals for 25% of the amount paid for health insurance premiums. The deduction was temporary and was initially in effect for tax years 1987 through 1989. It was extended but expired on June 30, 1992. Minnesota followed the federal treatment of the deduction while it was in effect. The full subtraction of health insurance premiums for the self-employed was enacted in 1992 as part of the Minnesota Health Right Act, beginning with tax year 1993.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$4,500,000	$10,900,000	$11,500,000

1.62 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491

A taxpayer may subtract from federal taxable income the income realized on a sale or exchange of farm property if the taxpayer is insolvent at the time of the sale, and the proceeds are used solely to discharge indebtedness of the property sold. The amount of the subtraction is limited to the excess of the taxpayer's debts over total assets plus the amount of any debt forgiveness excluded from income under Section 108 of the Internal Revenue Code.

This provision was enacted in 1985. It was repealed in 1987 but was re-enacted in 1988, retroactive to tax year 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

PREFERENTIAL COMPUTATION

1.63 FIVE-YEAR AVERAGING OF LUMP SUM DISTRIBUTIONS

Internal Revenue Code, Section 402(e)
Minnesota Statutes, Section 290.032

A lump sum distribution from a qualified pension, profit-sharing, or stock bonus plan is eligible for the special five-year averaging provision. A separate tax is computed on the lump sum distribution in isolation of other income of the taxpayer. The lump sum amount is divided by five; the tax on that amount is determined from the rate schedule for single persons; and the resulting tax is then multiplied by five and added to the tax, if any, on other income of the taxpayer.

The estimates measure the difference between the lump sum distribution tax and the additional regular income tax that would be paid if the entire lump sum was added to the income of the taxpayer in the year received. The averaging method results in the lump sum amount being taxed at a lower rate than if it were treated as other income.

Several restrictions apply to using lump sum averaging, including age and reason for distribution. The Minnesota provisions for lump sum averaging are the same as the federal except that Minnesota does not allow the option of ten-year averaging, and the capital gains portion is treated as ordinary income.

A ten-year averaging provision was adopted by Minnesota in 1975. In 1987 Minnesota adopted most of the federal changes enacted in 1986 that placed restrictions on the use of lump sum averaging.

Approximately 2,000 Minnesota taxpayers use lump sum averaging each year.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,300,000	$1,300,000	$1,300,000

CREDITS

1.64 CREDIT FOR INCOME TAX PAID TO OTHER STATES

Minnesota Statutes, Section 290.06, Sub. 22

A resident taxpayer may claim a nonrefundable credit for the amount of income tax paid to another state or Canadian province or territory to the extent that income taxed in the other state, province, or territory is included in Minnesota 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 times the percentage that the income earned in the other state is to federal adjusted gross income.

This credit was enacted in 1959 and was last changed in 1988.

This credit was claimed on 17,000 returns for tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$21,600,000	$23,300,000	$25,400,000

1.65 CHILD AND DEPENDENT CARE CREDIT

Internal Revenue Code, Section 21
Minnesota Statutes, Section 290.067

A Minnesota taxpayer may claim a refundable credit for a portion of dependent care expenses, depending on income, provided that those expenses were necessary in order to hold or look for a job. A dependent is defined as a child under age 13 or a person of any age who is disabled. Operators of family day care homes may claim the credit if they care for their own children under seven years old.

The determination of the credit amount starts with the federal child and dependent care credit, which is equal to eligible expenses multiplied by a percentage ranging from 30% to 20%, with the percentage decreasing as income increases. However, the state credit is subject to a maximum amount and to income restrictions. The maximum credit is $720 for one dependent and $1,440 for two or more dependents. For tax year 1992, these maximum amounts were reduced for taxpayers with total household income over $14,730, so that a taxpayer with total household income over $28,380 received no credit. The income levels at which the maximum credit is reduced are indexed each year for inflation.

The dependent care credit was enacted in 1977. In 1989 the income thresholds were changed and indexed. In 1991 the credit was extended to operators of licensed family day care homes, beginning with tax year 1992.

This credit was claimed on approximately 34,500 returns filed for tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$10,900,000	$11,100,000	$11,400,000

1.66 WORKING FAMILY CREDIT

Internal Revenue Code, Section 32
Minnesota Statutes, Section 290.0671

A refundable credit is allowed against the individual income tax equal to 10% of the federal earned income credit.

To qualify for the earned income credit, the taxpayer (and spouse) must have income from wages or self-employment but not exceeding a specified amount, adjusted gross income below a specified amount, and at least one minor child in the household. The credit is phased out as income increases. For tax year 1992 no credit is allowed for income of $22,370 or over.

The earned income credit has three components: the basic credit; a supplemental young child credit; and a health insurance credit. An individual may qualify for one, two, or all three parts of the federal credit. The Minnesota credit is equal to 10% of the total of the federal credits claimed.

The Minnesota working family credit was enacted in 1991, effective with tax year 1991.

The working family credit was claimed on 128,500 returns in tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$10,900,000	$12,000,000	$15,500,000

1.67 CONSTRUCTION FINANCING CREDIT (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(3)

A taxpayer may apply for a credit equal to a percentage of the cost of debt financing for construction of a new or expanded facility 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 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

1.68 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and 6(1)

Two separate refundable credits against the income tax are available to employers in designated enterprise zones.

1. An employer may claim a credit of up to $3,000 annually for each additional worker employed in a designated enterprise zone, other than workers employed in construction.

2. An employer in a designated border city enterprise zone may claim a credit of up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

The employer job credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$100,000

*Less than $50,000

CHAPTER 2: CORPORATE FRANCHISE TAX

Collections and History

For fiscal year 1992, net revenues from the corporate franchise tax were $423 million, equaling 5.7% of total state revenue. The proceeds from the corporate franchise tax go into the state general fund.

The Minnesota corporate income tax was enacted in 1933, along with the individual income tax. Several changes were made to the tax rate since 1933. At times it was a flat rate; at others, a graduated rate schedule applied. A flat rate of 9.5% was in effect for tax years 1987 through 1989, and the current rate of 9.8% has been in effect since 1990.

The bank excise tax was first enacted in 1941 at a rate of 8%. The bank excise tax was at a rate different from the corporate income tax until 1973. Beginning with tax year 1987, the separate bank excise tax is no longer imposed, and banks are subject to the corporate franchise tax.

In 1981 Minnesota adopted a domestic unitary method of taxation. A group of corporations is considered to be a unitary business when there is unity of ownership, operation, and use. Only domestic corporations, that is, those organized under United States federal or state law, are included in the unitary group. The Minnesota taxable income of a corporation that is part of a unitary group is determined by applying an apportionment formula to the combined net income of the unitary business.

In 1987 the corporate income and bank excise taxes were replaced by the corporate franchise tax, and, for the first time in the history of the Minnesota corporate tax, a federal definition of income (federal taxable income) was adopted. Although the Minnesota tax now conforms more closely to the federal, a number of modifications to federal taxable income still exist. In 1987 Minnesota also adopted many of the changes contained in the federal Tax Reform Act of 1986.

Several changes to the corporate franchise tax took effect in tax year 1990: An alternative minimum tax on tax preference items, similar to the federal, replaced the alternative minimum tax based on the total of Minnesota property, payroll, and sales; A minimum fee of up to $5,000 was imposed in addition to the regular or alternative minimum tax; The unrelated business income of exempt organizations became subject to the corporate franchise tax to the same extent that it is federally; The computation of the taconite and iron ore occupation tax was changed to follow the corporate franchise tax.

Beginning with tax year 1991, the computation of the corporate tax on insurance companies starts with the current definition of federal taxable income. Prior to that time, the tax on insurance companies was determined under the provisions of the federal Revenue Act of 1936. Also beginning in 1991, insurance companies domiciled in states other than Minnesota with retaliatory taxes were exempted from the Minnesota corporate tax. This exemption eliminates the imposition by other states of retaliatory franchise taxes on Minnesota-domiciled companies.

Tax Base

For purposes of this study, the tax base for the corporate franchise tax is defined to be income from all sources less expenses that are reasonable and necessary to generate that income. Such reasonable and necessary expenses are, therefore, not considered to be tax expenditures.

A tax expenditure is created when a certain type of income is excluded or when a deduction or credit is allowed for expenses other than those considered reasonable and necessary. For example, when depreciation measures the actual decline in the value of an asset during the tax year, it is considered a necessary business expense and not a tax expenditure. However, when accelerated depreciation or expensing is allowed, the excess over the actual depreciation is considered to be a tax expenditure.

Computation of the Tax

The computation of the corporate franchise tax is as follows:

	Income from all sources
minus:	federal exclusions
minus:	federal deductions
equals:	federal taxable income
plus:	Minnesota additions
	- state or foreign income taxes deducted federally
	- federally-exempt interest on government bonds
	- exempt-interest dividends paid by regulated investment companies
	- windfall profits tax deducted federally
	- net operating loss deducted federally
	- federal dividend received deduction
	- losses from mining subject to the occupation tax
	- federal capital loss deduction
	- federal charitable contribution deduction
	- exempt foreign trade income of a foreign sales corporation
	- federal percentage depletion deduction
	- amortization deduction for specified pollution control facilities
	- deemed dividends from foreign operating corporations
minus:	Minnesota subtractions
	- foreign dividend gross up
	- salary expenses disallowed federally due to claiming federal jobs credit
	- for banks, any dividend paid on its preferred stock to the federal government
	- previously disallowed deductions for intangible drilling costs
	- capital loss deduction with no carrybacks
	- interest and expenses on income that is exempt federally but taxed by the state
	- cost depletion for mines, oil and gas wells, other natural deposits, and timber
	- depreciation deduction for specified pollution control facilities
	- refundable enterprise zone credits included in taxable income
	- state income tax refunds
	- 80% of foreign source royalties, fees, etc. received within unitary group
	- income or gains from mining operations subject to the occupation tax
	- handicap access expenditures disallowed federally due to claiming the federal credit
	- research expenses disallowed federally due to claiming the federal credit
plus or minus:	modifications to the federal accelerated cost recovery system
equals:	total net income
times:	apportionment factor
equals:	Minnesota net income
minus:	Minnesota deductions
	- net operating loss
	- dividends received

	- Minnesota charitable contributions
equals:	Minnesota taxable income
times:	tax rate of 9.8%
equals:	gross tax
minus:	nonrefundable credits
	- research and development credit
	- gross premiums tax credit for insurance companies
	- alternative minimum tax carryover credit
plus:	alternative minimum tax
plus:	minimum fee
equals:	tax liability
minus:	refundable enterprise zone credits
equals:	net corporate franchise tax payable

For most multistate corporations, income is apportioned to Minnesota based on a weighted three-factor formula of 15% of the Minnesota property ratio, 15% of the Minnesota payroll ratio, and 70% of the Minnesota sales ratio. With special permission or under certain conditions, separate accounting or a single factor of sales may be used. For insurance companies, income is apportioned to Minnesota by the ratio that gross premiums collected in Minnesota is to total gross premiums collected for that year.

An alternative minimum tax on tax preference income, similar to its federal counterpart, is imposed if it exceeds the regular liability. The alternative minimum tax is equal to 5.8% of Minnesota alternative taxable income.

In addition to the regular or alternative minimum tax, a minimum fee is imposed, based on the sum of the corporation's Minnesota property, payroll and sales, as follows:

Total Minnesota Property, Payroll, and Sales	Minimum Fee
Less than $500,000	$ 0
$500,000 - $999,999	$100
$1,000,000 - $4,999,999	$300
$5,000,000 - $9,999,999	$1,000
$10,000,000 - $19,999,999	$2,000
$20,000,000 or more	$5,000

The unrelated business income of exempt organizations is subject to the Minnesota tax. The unrelated business income tax is based on the organization's federal taxable income, without the Minnesota additions to and subtractions from income applicable to other corporations.

Mining Occupation Tax

The occupation tax on taconite and iron ore is computed in the same way as the corporate franchise tax, with these exceptions: the starting point is the mine value of iron ore or taconite concentrates mined or produced in Minnesota; deductions allowed include only those expenses necessary to convert raw iron ore or taconite concentrates to marketable quality; the unitary principle is not applicable; and percentage depletion is allowed. Total occupation tax collections in fiscal year 1992 were $2 million. The tax expenditures for the occupation tax are not shown separately; they are included with the corporate franchise tax provisions. Because percentage depletion does not apply to other corporations, the fiscal impact for Item 2.14 applies only to occupation tax filers.

EXEMPT ORGANIZATIONS

2.01 CREDIT UNIONS

Internal Revenue Code, Section 501(c)(14)(A)
Minnesota Statutes, Section 290.05, Subd. 2

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

Credit unions have been specifically excluded from state income taxation since 1937. In 1981 Minnesota adopted the language found in Subchapter F of the Internal Revenue Code which excludes numerous organizations, including credit unions, from income tax.

In 1991 there were 240 credit unions in Minnesota with just over one million members.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$2,000,000	$2,100,000	$2,200,000

2.02 INSURANCE COMPANIES DOMICILED IN RETALIATORY STATES

Minnesota Statutes, Section 290.05, Subd. 1(c)

An insurance company is exempt from the corporate franchise tax if it is domiciled in a state or country, other than Minnesota, that imposes retaliatory taxes on insurance companies and does not grant, on a reciprocal basis, an exemption to Minnesota-domiciled companies. This exemption eliminates the imposition by other states of retaliatory franchise taxes on Minnesota-domiciled companies.

This exemption was enacted in 1989, effective beginning with tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$10,000,000	$10,000,000	$10,000,000

2.03 SMALLER MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANIES

Minnesota Statutes, Section 290.05, Subd. 1(d)

Mutual property and casualty insurance companies with total assets of $1.6 billion or less on December 31, 1989, are exempt from the corporate franchise tax. Although these companies are exempt from the regular and alternative minimum tax, they are subject to the minimum fee. Town and farmers' mutual insurance companies are exempt from the tax and from the minimum fee and are included in the estimates.

This exemption was enacted in 1989, effective beginning with tax year 1991. In 1990 the date of the asset test was set at December 31, 1989, instead of at the end of the previous year.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,000,000	$1,000,000	$1,000,000

FEDERAL EXCLUSIONS

2.04 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Section 7872
Minnesota Statutes, Section 290.01, Subd. 19

Section 7872 of the Internal Revenue Code contains imputed interest rules designed to prevent the assignment of income through the use of below-market or interest-free loans. When the rules apply, a lender is deemed to have received interest payments, and a borrower is deemed to have paid interest payments. Exempt from the imputed interest rules are loans of less than $10,000 if they are gift loans or if they are compensation related or are corporate-shareholder loans. Also exempt are loans to qualified continuing extended care facilities and certain employee home relocation loans. There is a special method for computing income from a gift loan of less than $100,000.

Imputed interest rules and exceptions to the rules were first effective in 1984 and were last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

2.05 INTEREST ON LIFE INSURANCE AND ANNUITY SAVINGS

Internal Revenue Code, Sections 72 and 101(a)
Treasury Regulation 1.451-2
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Interest earned on life insurance and annuity savings is not included in the recipient's gross income as it accumulates.

For a life insurance policy the exclusion applies to what is commonly referred to as "inside build-up" of investment income. When the premiums paid by the policyholder exceed the cost of insurance, the excess premiums are invested by the company, and the interest is credited to the policy. This interest is excluded from the policyholder's income as it accumulates.

If the policy is surrendered before the death of the policyholder, the excess of the cash surrender value over the premiums paid is included in income. In this situation, the income is deferred rather than excluded.

Policy proceeds paid because of the death of the insured are excluded from the gross income of a beneficiary. The accumulated interest paid to beneficiaries is never taxed.

An annuity is an investment contract sold by a life insurance company in which the owner makes a deposit in either a lump sum or installment payments in exchange for regular payments for a lifetime or for a specified number of years. The interest is not included in the gross income of the owner as it accumulates if the policyholder is a natural person. With certain exceptions, the deferral of interest income does not apply when an annuity is held by a corporation.

These exclusions have been in effect since the income tax laws were enacted in 1933. The last change occurred in 1983.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,500,000	$1,900,000	$2,600,000

2.06 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from the sale or exchange of property is recognized as income for tax purposes. However, the gain from a like-kind exchange is not recognized at the time of exchange if both the relinquished and the received property are held for productive use in a trade or business or for investment. The recognition of the gain is deferred until the received property is sold or otherwise disposed. In order for the gain to qualify for exclusion, the exchange must be concluded within specified time limits. This provision does not cover stock in trade or other property held primarily for sale, or stock, bonds, notes, or other securities.

Section 1031 was enacted in 1954 and was last amended in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,200,000	$1,200,000	$1,500,000

2.07 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

Internal Revenue Code, Section 458
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer who distributes magazines, paperbacks, and sound recordings and who uses the accrual method of accounting may elect to exclude from gross income for the taxable year the income attributable to the qualified sale of any magazine, paperback, or sound recording which is returned to the taxpayer before the end of the merchandise return period, even though the merchandise return period extends into the next taxable year.

A sale of such merchandise is a qualified sale if the merchandise is not resold and the taxpayer has a legal obligation to adjust the sales price if it is not resold. The excludable amount is the amount by which the price is adjusted. Separate rules govern how the excludable income is distributed over time for magazines and for paperbacks and records.

Section 458 of the Internal Revenue Code was enacted in 1978.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

2.08 GAINS FROM SALES TO EFFECTUATE POLICIES OF THE FEDERAL COMMUNICATIONS COMMISSION

Internal Revenue Code, Sections 1033 and 1071
Minnesota Statutes, Section 290.01, Subd. 19

Generally, a gain is included in income when property is sold or exchanged. However, the recognition of a gain is deferred when the property is involuntarily or compulsorily converted, such as through condemnation, theft, or seizure and the gain is reinvested in similar property.

When the sale or exchange of a radio broadcasting facility is certified by the Federal Communications Commission (FCC) to effectuate a new or changed policy of the FCC, then the sale may be treated as an involuntary conversion. In 1979 the FCC adopted a policy of encouraging minority ownership of broadcast facilities.

Section 1071 of the Internal Revenue Code was enacted in 1957 and was last changed in 1982. Minnesota adopted the federal provision in 1987 when federal taxable income was first used as the starting point for the corporate franchise tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$500,000	$500,000	$500,000

2.09 INVESTMENT INCOME FROM STRUCTURED SETTLEMENT ACCOUNTS

Internal Revenue Code, Section 104(a)(2) and 130
Minnesota Statutes, Section 290.01, Subd. 19

A structured settlement account may be set up when a person or company is determined, by lawsuit or agreement, to be responsible for making periodic payments as damages due to personal physical injury or sickness. The responsible party arranges with a third party (structured settlement company) to assume liability for the payments and makes a lump sum payment to the settlement company. The lump sum payment is used to purchase an annuity from an insurance company or a United States government bond, and the annuity or bond is used to fund the periodic payments to the injured party.

Except for the taxability of any profit from the arrangement to the settlement company, the transaction is tax free. The interest component of the annuity payments are not taxable to anyone because damage payments are excluded from the income of the recipient.

The exclusion of investment income from structured settlements was enacted in 1983. In 1986 the exclusion was limited to claims for physical injury or physical sickness, thereby eliminating damages paid for reasons such as defamation or invasion of privacy.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

2.10 ALTERNATIVE COMPUTATION FOR SMALL PROPERTY AND CASUALTY COMPANIES

Internal Revenue Code, Section 831(b)
Minnesota Statutes, Section 290.01, Subd. 19

A property and casualty company with written premiums of between $350,000 and $1.2 million can elect to be taxed only on its investment income. Under this election, underwriting income and deductions are not included in the determination of taxable income.

This provision was part of the federal Tax Reform Act of 1986 and replaced preferential provisions that were allowed only to small mutual companies. In 1989 Minnesota adopted the current definition of federal taxable income for insurance companies as the starting point for its tax and, thereby, this provision was incorporated in Minnesota law, beginning with tax year 1991.

Because insurance companies domiciled in retaliatory states and smaller mutual property and casualty companies are exempt from the corporate franchise tax, fewer than twenty companies are eligible for this special treatment.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

FEDERAL DEDUCTIONS

2.11 SMALL LIFE INSURANCE COMPANY DEDUCTION

Internal Revenue Code, Sections 804 and 806
Minnesota Statutes, Section 290.01, Subd. 19

A special deduction is available only to life insurance companies with assets of less than $500 million at the end of the tax year. The deduction is equal to 60% of the first $3 million of life insurance company taxable income and is reduced by 15% of any taxable income over $3 million, so that the deduction is reduced to zero at taxable income of $15 million and above.

This deduction was enacted federally in 1984. In 1989 Minnesota adopted the current definition of federal taxable income and, thereby, this provision, beginning with tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

*Less than $50,000

2.12 DEPRECIATION

Internal Revenue Code, Section 168
Minnesota Statutes, Section 290.01, Subd. 19 and 19e

Beginning with property placed in service after December 31, 1987, a corporate taxpayer is allowed a deduction for the depreciation of machinery, equipment, and structures used in a trade or business or held for the production of income equal to the deduction allowed federally under the modified accelerated cost recovery system (MACRS). Federally, MACRS applies to property placed in service after December 31, 1986 (July 31, 1986, in some cases).

Under MACRS, machinery or equipment is classified as either three-, five-, seven-, or ten-year property, and the 200% declining balance method is used. The 150% declining balance method applies to fifteen- and twenty-year property. Straight-line depreciation of 27.5 years is used for residential rental property, and 31.5 years is used for nonresidential real property.

For property placed in service after July 31, 1986, and before January 1, 1988, and for which the new rules apply, 15% of the federal deduction is disallowed. For property placed in service after December 31, 1980, and before January 1, 1987, 40% of the federal deduction is disallowed for fiften-, eighteen-, and nineteen-year real property, and 20% is disallowed for all other property. Methods are provided for deducting the remaining depreciation after the end of the federal recovery period.

Conceptually the tax expenditure is the extent to which depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. For machinery and equipment, the tax expenditure is measured as the difference between the current law depreciation schedule and straight-line depreciation over the period defined by the midpoint of the asset depreciation range (ADR) system that was in effect from 1971 to 1981. For structures, it is measured as the difference between current law depreciation and straight-line depreciation over forty years.

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 current depreciation provisions were enacted in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$72,200,000	$76,000,000	$79,900,000

2.13 EXPENSING DEPRECIABLE BUSINESS PROPERTY

Internal Revenue Code, Section 179
Minnesota Statutes, Section 290.01, Subd. 19

A corporation may elect to treat the cost of qualifying business property as an expense and to deduct the cost in the year the property is placed in service. The deduction is taken instead of the depreciation deduction.

The maximum annual deduction is $10,000 for property placed in service after 1986. If the corporation places more than $200,000 of qualifying personal property in service during the taxable year, then the $10,000 limitation is reduced by one dollar for each dollar that the cost exceeds $200,000. Therefore, no expensing deduction is allowed if the cost exceeds $210,000.

The estimates measure the difference between expensing the property and a depreciation deduction which would reflect the actual useful life of the property.

This provision was adopted in 1982. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$400,000	$400,000	$400,000

2.14 EXCESS OF PERCENTAGE OVER COST DEPLETION (MINING OCCUPATION TAX)

Internal Revenue Code, Sections 291, 611, 612, 613, and 613A
Minnesota Statutes, Section 298.01, Subd. 3b(b) and 4c(a)(1)

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

For the federal income tax, a corporation may choose either percentage depletion or cost depletion. For the Minnesota corporate franchise tax, only cost depletion is allowed. However, the option of percentage depletion or cost depletion is allowed for the mining occupation tax. Beginning with tax year 1990, the occupation tax on taconite and iron ore is similar to the corporate franchise tax, but one difference is that percentage depletion is allowed.

Cost depletion is based on the taxpayer's basis in the property and is similar to depreciation in its application. Percentage depletion 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 in excess of cost depletion is considered a tax expenditure.

For the federal income tax, a deduction for cost depletion was first allowed in 1913, and percentage depletion was first allowed as an option in 1926. Percentage depletion has never been allowed for the Minnesota corporate franchise tax. In 1989 percentage depletion was allowed for the mining occupation tax, beginning with the tax year 1990.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,200,000	$1,200,000	$1,200,000

2.15 AMORTIZATION OF ORGANIZATIONAL AND START-UP COSTS

Internal Revenue Code, Sections 195 and 248
Minnesota Statutes, Section 290.01, Subd. 19

Corporations which incur certain expenses during their initial organizational or start-up phase may elect to amortize those costs over a period of not less than sixty 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, and the deduction for start-up costs was added in 1980. The provision was last amended in 1985.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

2.16 SEVEN-YEAR AMORTIZATION OF REFORESTATION EXPENDITURES

Internal Revenue Code, Section 94
Minnesota Statutes, Section 290.01, Subd. 19

In general, investment costs such as those a timber grower incurs in clearing land and planting trees are considered capital outlays and may not be deducted from income until the trees are sold. However, timber growers have been provided with a special incentive for forestation or reforestation. Up to $10,000 expended in a year for reforestation can be amortized over seven years. Since timber growth periods are typically longer than fifteen years, this provision allows reforestation expenses to be deducted long before the general rule would allow them to be deducted.

The federal provision was enacted in 1980 and was last changed in 1982. In 1987 Minnesota adopted this provision for the corporate franchise tax, beginning with tax year 1987, by adopting federal taxable income as the starting point for the tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

2.17 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174
Minnesota Statutes, Section 290.01, Subd. 19

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. However, a corporation may elect to deduct as an 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 formula), then the taxpayer may alternatively elect to amortize the costs over not less than sixty months.

No substantive changes have been made to this provision since it was adopted in 1955.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$7,900,000	$8,300,000	$8,400,000

2.18 EXPENSING OF MAGAZINE CIRCULATION EXPENDITURES

Internal Revenue Code, Section 173
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to deduct as an expense in the current year expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical. This treatment is restricted to certain types of expenditures, and the election is binding for the current year and to similar expenditures in subsequent years.

The provision is a tax expenditure because, in general, expenses incurred in creating or developing an asset must be capitalized.

This provision was enacted by Minnesota in 1951 and was last amended in 1984.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

2.19 EXPENSING FOR REMOVAL OF BARRIERS TO THE HANDICAPPED AND ELDERLY

Internal Revenue Code, Sections 44(d)(7) and 190
Minnesota Statutes, Section 290.01, Subd. 19 and 19d(13)

A taxpayer may elect to expense qualifying barrier removal expenses in the year incurred instead of capitalizing them. To qualify, the removal of barriers must make a facility or public transportation vehicle owned or leased by the taxpayer for use in his trade or business more accessible to and usable by handicapped and elderly persons and must meet standards of the Architectural and Transportation Barriers Compliance Board. The maximum deduction per year is $15,000, and expenses used for the federal disabled access credit for small businesses are not deductible on the federal return. Minnesota allows a subtraction for expenses disallowed due to claiming the federal credit.

The federal provision was first effective for tax year 1977, and Minnesota first adopted this provision for corporate franchise tax purposes in 1987. In 1990 the maximum deduction was reduced from $35,000 to $15,000, and expenses used for the newly-enacted federal credit were disallowed. These changes were adopted by Minnesota in 1991, at which time Minnesota also enacted a subtraction for expenses disallowed due to taking the federal credit.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$500,000	$500,000	$500,000

2.20 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 263(c), 291, 465, 616, 617 and 1254
Minnesota Statutes, Section 290.01, Subd. 19

Current-year expensing is allowed for items such as labor, fuel, repairs, and site preparation costs incurred in the exploration and development of oil, gas, other fuel, and non-fuel mineral deposits.

Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are treated as capital expenses, which increase the taxpayer's basis in the property.

Expensing of exploration and development costs for all minerals was first allowed by Minnesota in 1967. Prior to 1987, Minnesota allowed this expensing deduction for minerals but not for oil and gas. In 1987 Minnesota conformed to the federal treatment for all the types of deposits mentioned by adopting federal taxable income as the starting point for the tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$800,000	$1,200,000	$1,300,000

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

Internal Revenue Code, Sections 162, 175, 180, 447, 464, 465, and 704(d)
Minnesota Statutes, Section 290.01, Subd. 19

A corporate taxpayer engaged in the business of farming may treat expenditures made during the tax year as expenses rather than as capital expenditures. Therefore, these expenditures are entirely deductible in the current year. To qualify for this special treatment the expenditures must be for soil and water conservation under a government-approved plan, the purchase and application of fertilizer, or certain preproduction costs.

The expensing of capital outlays is a tax expenditure because normally the cost of a capital outlay for land improvement would not be deductible but would be added to the basis of the property.

Family farm corporations are allowed to use cash accounting rather than the accrual system for income tax purposes if their annual gross receipts are $25 million or less. Therefore, costs attributable to goods not yet sold may be deducted in the current year. The accrual system is normally required for businesses with inventories.

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. Prior to 1987 the Minnesota corporate provision for expensing capital outlays pertained only to soil and water conservation but was broadened with the adoption of federal taxable income. In 1986 the expensing of soil and conservation expenditures was restricted, and in 1987 cash accounting was repealed for farms with annual gross receipts over $25 million. Minnesota adopted these federal changes in 1987 and 1988 respectively.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$1,700,000	$1,700,000	$1,700,000

2.22 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

Internal Revenue Code, Section 263A(d)
Minnesota Statutes, Section 290.01, Subd. 19

Farmers are allowed to deduct in the current year certain multiperiod production costs rather than follow the general capitalization rules. Expensing is allowed in two types of situations.

Farmers who are allowed to use cash accounting may elect to deduct currently all preproductive costs of animals and also of plants that have a preproductive period of two years or less. These costs must be recaptured as ordinary income upon disposition of the product, and the alternative depreciation system must be used for farm assets placed in service during a year in which the election is in effect. Vintners and orchard growers may expense the costs of replacing plants or trees that have been damaged by disease, pests, frost, or other natural disasters.

Expensing has always been allowed for these types of costs incurred by farmers. However, this provision was enacted as part of the federal Tax Reform Act of 1986 as an exception to the uniform capitalization rules adopted in that same act. This provision was last changed in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$600,000	$600,000	$600,000

2.23 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

Internal Revenue Code, Section 263A(c)(5)
Minnesota Statutes, Section 290.01, Subd. 19

Timber growers are allowed to deduct in the current year multiperiod production costs rather than following the general capitalization rules. The exception to the capitalization rules applies to the costs incurred in raising, growing, or harvesting trees other than trees bearing fruit, nuts, or other crops, or ornamental trees.

The capitalization rules were enacted as part of the Tax Reform Act of 1986. Although the expensing of timber growing costs was allowed previously, it is now considered a tax expenditure because the general rules that apply to other business activities are more restrictive. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$900,000	$900,000	$1,000,000

2.24 SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION RESERVES

Internal Revenue Code, Section 468
Minnesota Statutes, Section 290.01, Subd. 19

In general, expenses that will be incurred in the future may not be claimed as a current deduction. Under the accrual method of accounting, future expenses can be deducted only when the economic activity giving rise to the expense has occurred.

An exception is provided for mining and solid waste reclamation costs which are incurred in order to comply with a federal, state, or local law, as specified. A deduction may be taken in the current year for the estimated future reclamation or closing costs attributable to production or mining activity during the taxable year. A bookkeeping reserve must be maintained for tax purposes so that, when reclamation or closing costs are actually incurred, they can be compared to the deductions taken. Any excess of the reserve, including interest, over actual costs must be included in income at that time.

Section 468 was enacted in 1984 and was last changed in 1986. Minnesota first adopted this provision for corporate tax purposes in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$100,000	$100,000	$100,000

2.25 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Section 446
Minnesota Statutes, Section 290.01, Subd. 19

Section 446 of the Internal Revenue Code allows a taxpayer to choose the cash method of accounting instead of the accrual method. The accrual method is considered a better measure of current-year income and expenses because it takes into account the income of receivables. This tax expenditure is the difference in net income measured by accrual accounting and cash accounting.

A corporation may use cash accounting only if it meets one of the following conditions: average annual gross receipts of $5 million or less; qualified personal service corporation; farming corporation; or timber corporation.

Cash accounting has been permitted since 1933. Prior to the 1986 federal changes which were adopted by Minnesota in 1987, cash accounting could be used by any corporation that did not maintain an inventory.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

2.26 INSTALLMENT SALES

Internal Revenue Code, Sections 453, 453A, and 453B
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain or loss from the sale of property is recognized in the year of the sale. An exception to the above rule is the installment method. The installment method of reporting may be used to report gains if at least one payment is received in a tax year other than the year of sale. Under the installment method, gross profit is prorated over the period in which payments are received. The tax expenditure is the difference between what tax liability would be under year-of-sale reporting and what it is under installment reporting.

The option to use the installment method is generally limited to casual sales of noninventory personal property and certain sales of real property.

The installment method was first enacted in 1933. In 1986 the installment method was eliminated for revolving credit sales of personal property and sales of property regularly traded on an established market, such as stocks or securities. In 1987 the installment method was repealed for dealer sales of both real and personal property. The 1986 and 1987 federal changes were adopted by Minnesota in 1987 and 1988 respectively.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$400,000	$400,000	$400,000

2.27 PATRONAGE DIVIDENDS (COOPERATIVES)

Internal Revenue Code, Sections 1381-1388
Minnesota Statutes, Section 290.01, Subd. 19

Cooperatives engaged in buying, selling, or production may deduct from gross income amounts which are distributed to customers or patrons in the form of patronage dividends. Dividends can be paid in cash or noncash form. Agricultural and consumer cooperatives are the primary beneficiaries of this provision. This deduction is not available to consumer credit cooperatives, rural cooperatives providing electricity or telephone service, or mutual insurance or savings associations.

This deduction is a tax expenditure because other corporations are taxed on their earnings before distribution.

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

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$7,000,000	$7,300,000	$7,600,000

2.28 EXCESS BAD DEBT RESERVES OF FINANCIAL INSTITUTIONS

Internal Revenue Code, Sections 585, 593, and 596
Minnesota Statutes, Section 290.01, Subd. 19

Generally, 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 corporation includes as income all amounts that it has earned the right to receive. A bad debt deduction reduces accrued income by the amount that the taxpayer did not receive.

Large commercial banks (those with assets exceeding $500 million) must use the charge-off method to determine a bad debt deduction. Under the charge-off method, the bad debt deduction can be taken only when the debt actually becomes worthless. The use of the charge-off method is not considered a tax expenditure.

Smaller banks and thrift institutions have the option of using the charge-off method or one of the reserve methods. Under the reserve methods, a deduction which is in excess of actual experience may be taken at the end of the taxable year. Limitations are placed on the amount a financial institution adds to its bad debt reserves, and separate limitations apply to smaller banks and to thrifts. The tax expenditure is measured as the reduction in tax under the reserve method as compared to the charge-off method.

The reserve method was first allowed for use by banks in 1947 and by thrifts in 1952. The repeal of the reserve method for large commercial banks and the changes in the limitations for other institutions were enacted federally in 1986 and were adopted by Minnesota in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$600,000	$600,000	$700,000

2.29 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 133, 404(k), and 1042
Minnesota Statutes, Section 290.01, Subd. 19

An employee stock ownership plan (ESOP) is a qualified stock bonus plan or a combination of a stock bonus and a money purchase pension plan under which a tax-exempt trust holds employer stock for the benefit of the employees. The stock may be acquired through direct employer contributions or with the proceeds of a loan to the trust. There are three components to the ESOP tax expenditure: exclusion of interest on ESOP loans; dividend deduction; and nonrecognition of gain on stock sales.

Banks or other qualified lenders may exclude from gross income 50% of the interest earned on loans which are used by a corporation or an ESOP to acquire employer securities for an ESOP. The ESOP must own at least 50% of the corporation's stock for the partial interest exclusion to apply.

A corporation is allowed to deduct from its income dividends paid to an ESOP and dividends used to make payments on ESOP loans.

If a corporation sells qualified stock to an employee organization, the corporation does not recognize the gain on the sale. In order to qualify for the nonrecognition treatment, certain conditions must be met by the buyer and seller. The stock in the sale must be qualified stock, that is, stock which has no readily tradable securities outstanding. The buyer of the stock must be an employee organization which is defined as an ESOP or a worker-owned cooperative, and after selling the stock the corporation must reinvest in another domestic corporation. Also, after the sale is completed, the employee organization must own at least 30% of the company stock.

The federal provisions were enacted in 1984 and were amended by the 1986 Tax Reform Act. Minnesota adopted the dividend deduction and the nonrecognition of gain on stock sales in 1984. In 1987 Minnesota adopted the interest exclusion along with the 1986 federal changes. In 1989 the requirements for the partial interest exclusion and dividend deduction were changed.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$4,100,000	$4,400,000	$4,500,000

2.30 INVENTORY PROPERTY SALES SOURCE RULE EXCEPTION

Internal Revenue Code, Section 865(b) and (i)
Minnesota Statutes, Section 290.01, Subd. 19

According to the general rule contained in the federal Tax Reform Act of 1986, income from the sale of personal property by a United States corporation is considered United States-source income, and income from the sale of personal property by a foreign corporation is foreign-source income. An exception to that rule applies to the sale of inventory property which is sourced not by residency but at the location where the sale occurs.

Prior to the Tax Reform Act of 1986, the sale of all personal property was sourced at the location of the sale. With the adoption of a general residency rule, the exception for inventory property is considered a tax expenditure to the extent that United States corporations sell inventory property outside the United States. Minnesota adopted these provisions in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$16,100,000	$16,800,000	$17,300,000

2.31 CAPITAL CONSTRUCTION FUNDS OF SHIPPING COMPANIES

Internal Revenue Code, Section 7518
Minnesota Statutes, Section 290.01, Subd. 19

Section 7518 of the Internal Revenue Code provides tax incentives to shipping companies which own or lease vessels operating in the foreign or domestic commerce of the United States or in United States fisheries.

If the taxpayer enters into an agreement with the appropriate federal agency, deposits in a capital construction fund may be deducted from taxable income up to the portion of taxable income attributable to the operation of the vessel covered by the agreement. Earnings on the fund, which also may include nondeductible deposits, are exempt from taxation.

Withdrawals from the fund are not taxable if they are used to acquire, construct, or reconstruct vessels covered by the agreement. Such a withdrawal is treated first as made out of the capital account, second as made out of the capital gain account, and third as made out of the ordinary income account. Provisions are made for the adjustment of basis.

In general, these provisions were contained in the 1936 Merchant Marine Act and have applied federally since that time. The provisions were modified somewhat and codified in the federal Tax Reform Act of 1986. Minnesota first adopted these provisions in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

2.32 UNPAID PROPERTY LOSS RESERVES OF PROPERTY AND CASUALTY INSURANCE COMPANIES

Internal Revenue Code, Section 832(b)(5)
Minnesota Statutes, Section 290.01, Subd. 19

A property and casualty company can deduct additions to reserves for losses from its underwriting business, including not only losses incurred and paid but also losses incurred but not paid, anticipated losses not yet reported, and contested claims. Unpaid losses must be discounted to account partially for the time value of money.

The deduction for unpaid losses was enacted federally in 1954 and the discounting requirement was added in the federal Tax Reform Act of 1986. In 1989 Minnesota adopted the current definition of federal taxable income for insurance companies and, thereby, this provision, beginning with tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$800,000	$900,000	$1,000,000

*Less than $50,000

2.33 SPECIAL TREATMENT OF LIFE INSURANCE COMPANY RESERVES

Internal Revenue Code, Section 807(a) and (b)
Minnesota Statutes, Section 290.01, Subd. 19

A life insurance company can deduct from its gross income the increase in its life insurance reserves and must add to its gross income any decrease in its reserves. The deduction for the increase in reserves is a tax expenditure because it is for future payment of claims, not claims already filed and paid.

This deduction was enacted in 1984. In 1989 Minnesota adopted the current definition of federal taxable income and, thereby, this provision, beginning with the tax year 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$2,500,000	$2,700,000	$2,800,000

APPORTIONMENT

2.34 WEIGHTED APPORTIONMENT

Minnesota Statutes, Section 290.191

Minnesota allows a corporation to apportion its income to Minnesota by using a three-factor formula of the Minnesota ratios of property, payroll, and sales. The corporation uses a weighted ratio of 15% property, 15% payroll, and 70% sales. Prior to tax year 1987, a corporation could use the lesser of the weighted ratio or the average of the three ratios.

Some corporations would pay a higher tax using the average of the three ratios; others would pay less. The fiscal impact is the net increase in revenues that would result from using the average ratio formula compared to the weighted ratio formula. The increase in revenues for only those corporations that benefit from the weighted ratio would be about double the estimates shown below.

Minnesota first allowed manufacturing firms the option to choose between the two formulas in 1939. Nonmanufacturing firms were given the same option in 1953. In 1987 the option to use the average ratio formula was repealed.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$30,700,000	$37,700,000	$37,800,000

2.35 THROWBACK SALES

Minnesota Statutes, Section 290.191, Subd. 5

The Minnesota sales factor in the three-factor apportionment formula is determined by the destination of the sales. If a corporation with property and payroll in Minnesota makes sales from Minnesota to a customer in a state in which the selling corporation has no nexus and is therefore not taxable, the sales are not attributed anywhere. The Multistate Tax Compact and the tax laws of many states address this issue with a throwback rule. The throwback rule requires that a sale be thrown back to the state of the origin of the sale if the selling corporation is not taxable in the state of the purchaser. Sales to the federal government are also thrown back because of the difficulty in determining the destination of the sales.

Minnesota has no throwback rule. Therefore, the apportionment factor and taxable income are lower for some corporations than would occur under a throwback rule. For example, a corporation with 100% of its property and payroll in Minnesota and 10% of its sales in Minnesota has an apportionment factor of 37% under existing law but would have a factor of 100% under the throwback rule. The other 63% of income is not apportioned anywhere.

Prior to 1973 Minnesota used an origin-of-sale basis for corporate apportionment. In 1973, when Minnesota switched to a destination sale basis, throwback was not adopted. This provision was changed last in 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$21,800,000	$21,800,000	$21,800,000

2.36 SINGLE-FACTOR APPORTIONMENT FOR MAIL ORDER COMPANIES

Minnesota Statutes, Section 290.191, Subd. 4

A business which consists exclusively of selling tangible personal property and services by mail order or telephone and has at least 99% of its property and 99% of its payroll in Minnesota may apportion its income to Minnesota based only on the percentage of sales delivered in Minnesota. Without this provision, the business would use the weighted apportionment formula (Item 2.34). The property and payroll at a distribution center outside Minnesota are disregarded in meeting the 99% property and payroll requirements if the sole activity at the distribution center is filling orders and no solicitation of orders occurs there.

This provision was enacted in 1985. In 1988 the qualifying Minnesota portion of property and payroll was reduced from 100% to 99%. In 1992 the exception for out-of-state distribution centers was enacted.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$2,100,000	$2,300,000	$2,500,000

MINNESOTA SUBTRACTIONS

2.37 DIVIDEND RECEIVED DEDUCTION

Minnesota Statutes, Section 290.21, Subd. 4

In computing Minnesota taxable income, a corporation adds back the federal dividend received deduction and determines a separate Minnesota dividend received deduction which is subtracted after income is apportioned.

The deduction is 80% of the dividends received if the recipient owns 20% or more of the stock of the paying corporation. The deduction is 70% if the recipient owns less than 20%. Under certain circumstances, including reorganization, the deduction can be 100%. The dividends are deductible only to the extent they are included in Minnesota taxable net income which is after apportionment.

The dividend received deduction is not allowed if: the corporate stock is included in the inventory of the taxpayer corporation; the corporation holds the stock primarily for sale to customers in the ordinary course of business; or the business of the corporation consists mainly of holding the stocks and collecting income and gains from them.

The dividend received deduction was enacted in 1947. Major changes were made to this provision in 1987 and 1988 when the percentages of the deduction were reduced and the conditions were modified. In 1989 the provisions allowing a 100% deduction under certain circumstances were adopted.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$30,400,000	$37,400,000	$37,500,000

2.38 CHARITABLE CONTRIBUTIONS

Minnesota Statutes, Section 290.21, Subd. 3

Minnesota does not adopt the federal charitable contribution deduction. The federal deduction must be added back to federal taxable income, and a separate Minnesota deduction for charitable contributions is determined, which is subtracted after income is apportioned.

A deduction is allowed for charitable, public purpose, religious, scientific, literary, artistic, or educational contributions made to an organization located in and carrying on substantially all of its activity in Minnesota. A deduction is also allowed for a contribution to a foundation carrying out most of its activities outside Minnesota, but only a portion is deductible equal to the foundation's expenditure for Minnesota organizations to its total expenditures. A deduction for a contribution to the United States government is allowed only for real property located in Minnesota.

The contribution deduction is limited to 15% of the taxpayer's net income less the deduction allowed for dividends received; no carryovers are allowed.

This deduction was enacted in 1933. In 1987 the deduction was eliminated for contributions to organizations in other states, and the deduction for contributions to the United States government was restricted to real property located in Minnesota. In 1988 a deduction for contributions to foundations in other states was allowed up to the proportion of the foundation's expenditures for organizations in Minnesota.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$8,600,000	$9,100,000	$9,500,000

2.39 FOREIGN SOURCE INCOME

Minnesota Statutes, Section 290.01, Subd. 6b, 19c(13), and 19d(11); 290.17, Subd. 4(f)-(i); and 290.191, Subd. 5(a)

Most foreign income is not taxed by Minnesota, which is the net effect of a number of provisions.

For royalties, fees, and other like income received from a foreign operating corporation or a foreign corporation that is part of the same unitary group as the receiving corporation, 80% of such income is subtracted from federal taxable income.

In addition to the subtraction for income received from a foreign operating corporation, income earned by a foreign operating corporation is also subject to special provisions. A foreign operating corporation is defined as a domestic corporation that is: part of a unitary group having at least one member taxable in Minnesota; and either the average of its property and payroll percentages assigned inside the United States is 20% or less, or it has a valid election under Section 936 of the Internal Revenue Code.

The adjusted net income of a foreign operating corporation is deemed to be paid as a dividend to its shareholders, and the deemed dividend is eligible for the dividends received deduction. Dividends actually paid by a foreign operating corporation to a corporate shareholder which is a member of the same unitary group are eliminated from the net income of the unitary business. A foreign operating corporation is not required to file a Minnesota return, and its apportionment factors are not included in the apportionment factors of the unitary business.

All foreign source royalties were deductible for tax years 1985 and 1986. In 1987 the deduction was reduced from 100% to 35%. The current provisions were enacted in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$21,000,000	$21,500,000	$22,100,000

2.40 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491

A taxpayer may subtract from federal taxable income the income realized on a sale or exchange of farm property if the taxpayer is insolvent at the time of the sale, and the proceeds are used solely to discharge indebtedness of the property sold. The amount of the subtraction is limited to the excess of the taxpayer's debts over total assets plus the amount of any debt forgiveness excluded from income under IRC Section 108.

This provision was enacted in 1985. It was repealed in 1987 but was re-enacted in 1988, retroactive to tax year 1987.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

CREDITS

2.41 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

A corporate taxpayer may claim a nonrefundable credit against the franchise tax based on the increase in qualified expenditures for research and development performed solely within Minnesota. Expenditures include wages, costs of supplies, computer costs, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

The credit is equal to 5% of the first $2 million of current-year research expenditures over the base amount and 2.5% of the excess over $2 million. The base amount is determined by multiplying the corporation's percentage of gross receipts spent on research for tax years 1984 through 1988 (but not over 16%) by the average gross receipts of the company for the previous four years. Start-up companies with fewer than three years in the 1984-1988 period use 3% in the computation. Only Minnesota gross receipts and Minnesota research expenditures are used. The credit is nonrefundable, but any excess credit can be carried forward up to fifteen years.

The research and development credit was enacted in 1981, and in 1987 the percentages were reduced from 12.5% and 6.25% to 5% and 2.5%, respectively. The computation of the base amount was changed, beginning with tax year 1990. Unlike the federal credit, the Minnesota credit does not have an expiration date.

This credit was claimed on 270 returns filed in 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$11,000,000	$11,300,000	$11,700,000

*Less than $50,000

2.42 CONSTRUCTION FINANCING CREDIT (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(3)

A corporation may apply for a credit equal to a percentage of the cost of debt financing for construction of a new or expanded facility 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 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$900,000	*	*

2.43 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and 6(1)

Two separate refundable credits against the income tax are available to employers in designated enterprise zones.

1. An employer may claim a credit of up to $3,000 annually for each additional worker employed in a designated enterprise zone, other than workers employed in construction.

2. An employer in a designated border city enterprise zone may claim a credit of up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

The employer job credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$700,000	$300,000	*

*Less than $50,000

2.44 CREDIT FOR GROSS PREMIUMS TAX (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35, Subd. 3

Insurance companies doing business in Minnesota may take a credit against the corporate franchise tax for the amount of Minnesota gross premiums tax paid during the tax year.

This credit was enacted in 1937. In 1987 the credit was recodified but was not changed. Beginning with tax year 1991, a number of changes to the corporate franchise tax on insurance companies took effect. Exempt from the tax are insurance companies domiciled in states other than Minnesota that have retaliatory taxes and mutual property and casualty companies with assets of $1.6 billion or less on December 31, 1989. These companies are no longer required to file in Minnesota and are not represented in the estimates.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$10,400,000	$10,400,000	$10,400,000

2.45 AIRCRAFT MAINTENANCE AND ENGINE REPAIR FACILITIES JOB CREDIT

Minnesota Statutes, Section 290.06, Subd. 24

A credit against the corporate franchise tax is available to a corporation that leases and operates a heavy maintenance base for aircraft and/or an engine repair facility. The credit is equal to $5,000 multiplied by the number of full-time employees at each facility.

The credit is available for the first five taxable years that the facility is in operation. For the first year that the facility is in operation, the credit cannot exceed 80% of the wages paid during that tax year. For each of the succeeding four years, that percentage is 20%. If the credit exceeds the amount of tax, the unused portion can be carried forward up to ten years.

To qualify, the heavy maintenance facility must be owned by the State of Minnesota or one if its political subdivisions and leased to the corporation. The aircraft engine repair facility must meet the specifications described in Minnesota Statutes, Section 116R.02, Subd. 6. The specifications include that the facility is located in the city of Hibbing and that the construction of the facility is financed with specified bonding authority.

This credit was enacted in 1991 as part of a financing package for construction of a heavy maintenance facility in Duluth and a jet engine repair facility in Hibbing. The estimates are based on the tentative schedule for start up of operations of the two facilities at the time of publication.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$0	$0	$1,300,000

2.46 DESIGNATED COUNTY JOB CREDIT

Minnesota Statutes, Section 290.0691

A credit is available for a tax year starting in 1993 to businesses with operations located in a designated county. The credit is equal to $2,000 multiplied by the increase in the number of eligible employees over the previous year. An eligible employee is defined as a full-time employee with an annual wage of at least $15,000. The credit cannot be claimed for an employee in a position that was transferred from another location in Minnesota. The nonrefundable credit is allowed for tax year 1993 only, with no carryover.

All of these requirements must be met for a county to qualify as a designated county: population decline of at least 10% from 1980 to 1990; adoption of a county-wide economic development plan; designation as a star county by the Minnesota Department of Trade and Economic Development; and establishment of an economic development authority by each city in the county. A city of the second class that is designated as an economically depressed area by the United States Department of Commerce may also qualify. At the time of publication it appears that only Faribault County and the city of South St. Paul will qualify under these requirements.

The statute limits the total amount of credits payable to $200,000. If the credits claimed exceed the limit, the credit per employee is reduced proportionately. The fiscal impact assumes that the total available credit is claimed and that it is all claimed by corporate taxpayers.

This credit was enacted in 1992.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$0	$200,000	$0

CHAPTER 3: ESTATE TAX

Collections and History

Revenues from the Minnesota estate tax were $21.8 million in fiscal year 1992. All revenues from this tax go into the state general fund.

In 1905 a tax on the estates of decedents was first enacted in Minnesota in the form of an inheritance tax. Minnesota had an inheritance tax until 1979 when it was repealed and an estate tax was adopted. The inheritance tax was imposed on each individual who received property from an estate, and the amount of tax depended upon the amount of property received and the relationship of the recipient to the decedent. The estate tax is imposed on the taxable estate before it is distributed.

Major changes in the federal estate tax were enacted in 1981, and Minnesota 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.

In 1985 the computation of the Minnesota estate tax was changed to equal the Minnesota portion of the federal tax credit for state death taxes, known as the "pick-up tax".

Tax Base

The tax base for the estate tax is defined for this study as the net estate transferred. In other words, it is gross estate less administrative costs and other necessary and reasonable expenses paid before the estate is distributed. Therefore, a tax expenditure is created in the estate tax when a certain component of the estate is exempted or excluded because of its source or when a distribution is excluded from taxable estate because of the identity of the recipient. Preferential valuations are also considered to be tax expenditures.

Computation of the Tax

The Minnesota estate tax is equal to the Minnesota portion of the maximum federal credit for state death taxes, which is computed as follows:

	Gross estate
minus:	federal exclusions
equals:	federal gross estate
minus:	federal exemptions and deductions
equals:	federal taxable estate
minus:	$60,000
equals:	federal adjusted taxable estate
times:	graduated rates (0.8% to 16%)
equals:	maximum credit for state death taxes
times:	proportion of Minnesota gross estate to federal gross estate
equals:	Minnesota estate tax

An estate tax return must be filed if the decedent's federal gross estate exceeds $600,000. For the estate of a resident decedent, an alternate computation is used if it results in a tax larger than the pick-up tax. The alternate tax is equal to the maximum federal credit for state death taxes minus the death tax paid to the other state. Therefore, the alternate computation would be used only when the other state's tax was less than its share of the pick-up tax.

PREFERENTIAL VALUATION

3.01 SPECIAL USE VALUATION

Internal Revenue Code, Section 2032A
Minnesota Statutes, Section 291.03

Property is generally included in an estate at its fair market value on the date of death. 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 it is less than the market value. Specified conditions must be met in order to qualify for this treatment, and the total decrease in the value of the property for which the special use valuation applies cannot be more than $750,000. The estimates measure the difference between tax liability using the fair 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. In 1985 Minnesota adopted this provision through the federal pick-up tax.

The special use valuation was claimed on an average of eight returns during the fiscal years 1989 through 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

EXCLUSIONS

3.02 LIFE INSURANCE PROCEEDS

Internal Revenue Code, Section 2042
Minnesota Statutes, Section 291.03

In general, life insurance proceeds payable to an estate or to any beneficiaries are included in gross estate. However, the proceeds payable to a beneficiary(ies) may be excluded from gross estate if the decedent had forfeited the right to any benefit from or control over the policy.

To qualify for the exclusion, the decedent must have possessed none of the incidents of ownership in the policy at the time of death. The incidents of ownership include the power to change the beneficiary, the power to cancel or surrender the policy, the power to obtain a loan against the policy or to use the policy as collateral, and the right to any of the policy's economic benefits.

The estimates below do not include death benefits paid to a spouse because such benefits would also be exempt under the marital deduction (Item 3.05).

This provision was originally enacted in 1951 under the inheritance tax. With some modification, it was carried over to the estate tax in 1979. Minnesota adopted the federal provision through the pick-up tax in 1985.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,900,000	$4,200,000	$4,500,000

3.03 ANNUITIES

Internal Revenue Code, Section 2039
Minnesota Statutes, Section 291.03

For the estates of decedents dying after December 31, 1984, most annuities are included in gross estate. An exclusion is allowed only if one of these conditions is met: 1) on December 31, 1984, the decedent was both a participant in the plan and in pay status, and the decedent irrevocably elected the form of the benefit before July 18, 1984; or 2) the decedent separated from service before January 1, 1985, and did not change the form of benefit before death. Because these conditions are rarely met, most annuities cannot be excluded.

An exclusion for pensions and annuities was enacted in 1959 as part of the inheritance tax and was carried over to the estate tax in 1979. Federal changes enacted in 1984 eliminated the excludability for most pensions and annuities, and Minnesota fully adopted the changes in 1985 through the federal pick-up tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

3.04 SOCIAL SECURITY BENEFITS

Revenue Rulings 57-87 and 67-277
Minnesota Statutes, Section 291.03

Social security lump sum death benefits which are paid to surviving spouses and dependents 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. In 1985 Minnesota adopted this provision through the federal pick-up tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

DEDUCTIONS

3.05 MARITAL DEDUCTION

Internal Revenue Code, Section 2056
Minnesota Statutes, Section 291.03

The net value of all property passing from a decedent to a surviving spouse may be deducted from 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.

A marital deduction was enacted 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. An unlimited marital deduction was enacted in 1981. In 1985 Minnesota adopted the federal provision through the pick-up tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$24,000,000	$24,000,000	$24,000,000

3.06 CHARITABLE GIFTS

Internal Revenue Code, Section 2055
Minnesota Statutes, Section 291.03

Gifts from an estate to certain persons or organizations are excluded from gross estate for tax purposes. Qualifying recipients include charitable, scientific, literary, educational, and religious organizations and federal, state, and local governments.

An inheritance tax exemption for charitable gifts was enacted in 1911. In 1985 Minnesota adopted the federal deduction for charitable gifts through the pick-up tax.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$5,300,000	$5,300,000	$5,300,000

CHAPTER 4: SALES AND USE TAX

Collections and History

Revenues from the general sales and use tax totaled $2.2 billion in fiscal year 1992, making it the second largest source of state revenue with 29.7% of the total. The revenues from the sales and use tax are deposited in the state general fund and the local government trust fund. The revenues from the 0.5% county option tax plus the revenues from a state rate of 1.5% are deposited in the local government trust fund; the remainder (4.5% when the rate is 6.5%) is deposited in the state general fund.

The Minnesota general sales and use tax was enacted in a special session of the 1967 Legislature and became effective on August 1, 1967, at a rate of 3%. The rate was increased to 4% on November 1, 1971, 5% on July 1, 1981, and 6% on January 1, 1983. A county local option sales tax of 0.5% was authorized in 1991. Currently, all 87 counties impose the tax which is collected by the state, so that the general rate statewide is 6.5%.

Note: Throughout Chapters 4 and 5, the combined state and local rate of 6.5% is used, without separate references to the state rate portion and the county option portion. The fiscal impact of the tax expenditures is not shown separately for the state general fund and the local government trust fund but is available for any item upon request.

Many changes have been made to the sales tax base since 1967, with some exemptions being repealed and others being added. Also, a number of services were added as taxable sales.

The major exemptions repealed since 1967 include: cigarettes, 1981; candy and soft drinks, 1982; purchases by state government, interstate telephone service, and most nonprescribed drugs and medicine, 1987 (analgesics re-exempted in 1988); and the general exemption for sales to local government (exemption retained for school districts), 1992.

Among the major exemptions enacted were: residential heating fuel, 1978; residential water, 1979; repair and replacement parts for farm machinery, 1985; and capital equipment in new or expanding industries, 1989 (taxed at a reduced rate since 1984).

A number of services were added to the tax base in 1987, including parking, laundry and dry cleaning, building and residential cleaning, maintenance and exterminating, detective and security services, pet grooming, and lawn and garden services. In 1989 the tax was extended to solid waste collection and disposal services.

A separate motor vehicle excise tax (Chapter 5) was enacted, effective January 1, 1972. Prior to that time, motor vehicles were subject to the general sales and use tax.

Tax Base

For purposes of this study, the tax base for the general sales and use tax is defined as the gross receipts from the sale of tangible personal property or services to the final consumer. However, this fairly simple definition requires some explanation.

This definition is a working definition for this study and should not be interpreted as a presumption of what the ideal tax base should be. Although services could properly be considered outside the tax base, they are included in the tax base for this study because some services are taxed.

Sales for resale in the regular course of business are not included in the tax base because they are not a sale to the final consumer. In agricultural and industrial production, the sales of raw materials, component parts, and products consumed directly in the process are considered to be for resale, and therefore the exemption of these items is not a tax expenditure. However, the sale of machinery, equipment, and tools used in agricultural or industrial production is not considered a sale for resale. Therefore, a tax expenditure is created when a certain type of machinery, equipment, or tools is exempt from the sales tax or is taxed at a reduced rate.

Although the tax base would include motor vehicles, the exemption of motor vehicles from the sales tax is not considered a tax expenditure because motor vehicles are subject to an alternative tax, the motor vehicle excise tax.

Computation of the Tax

The sales tax is imposed on the gross receipts from taxable sales made by any person in Minnesota. The complementary use tax is imposed on the storage, use, or consumption in Minnesota of taxable personal property unless the Minnesota sales tax was paid on the sales price. The rate for both the sales tax and the use tax is 6.5%, which includes a 0.5% local option sales tax which has been adopted by every county. An additional 2.5% tax is imposed on alcoholic beverages, both on-sale and off-sale. Farm machinery and logging equipment are taxed at a rate of 2.5% instead of 6.5% (Items 4.54 and 4.55) and special tooling is taxed at 4.5% (Item 4.56).

Generally, a retail sale is subject to the tax unless it is specifically exempted by law. Taxable sales also include: selling, leasing, or renting tangible personal property; the furnishing of meals or drinks for a consideration; the furnishing for a consideration of lodging for less than thirty days; the admission to places of amusement or athletic events; the furnishing for a consideration of electricity, gas, water, or steam; and telephone service.

The tax is imposed on the sales price of the item, which is defined as the total consideration valued in money, whether paid in money or otherwise. Exclusions from the sales price include: property taken in trade for resale; cash discounts; and separately-stated interest, finance, or carrying charges.

The sales tax is paid by the purchaser to the seller; the seller collects and remits the tax to the state. The use tax is paid directly by the purchaser to the state.

EXEMPTIONS - PARTICULAR GOODS AND SERVICES

4.01 FOOD PRODUCTS

Minnesota Statutes, Sections 297A.01, Subd. 3(c) and 297A.25, Subd. 2
Minnesota Rules, Part 8130.4700

Generally, food purchased for home consumption is exempt from the sales tax, while food that is prepared and served, such as by a restaurant, is taxable, as is food sold in vending machines. Taxable items also include candy, chewing gum, soft drinks and other carbonated beverages, ice, heated food and drinks, hand-prepared ice cream or ice milk products, and sandwiches and party trays prepared by the retailer.

Food items that would otherwise be taxable but are exempt because of the identity of the seller are estimated separately. See Items 4.48, 4.49, and 4.50.

The exemption for food products was included when the sales and use tax was enacted in 1967. Candy and soft drinks were included in the exemption until 1982. The provision was last changed in 1984.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$329,000,000	$347,100,000	$368,000,000

4.02 CLOTHING AND WEARING APPAREL

Minnesota Statutes, Section 297A.25, Subd. 8 and 41
Minnesota Rules, Part 8130.5400

Generally, all clothing, whether new or used, is exempt from the sales and use tax. The exemption includes inner and outer wear, footwear, headwear, gloves and mittens, neckwear, belts, hosiery, and similar items customarily worn for general use. Also exempted 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, handbags, billfolds, sports clothing sold for exclusive use in a sporting activity, or work-related safety articles.

The exemption granted for clothing was included in the sales and use tax statutes enacted in 1967. An exemption was enacted in 1988 for bullet-proof vests sold to licensed peace officers.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$224,500,000	$246,200,000	$267,600,000

4.03 DRUGS AND MEDICINES

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

An exemption from the sales and use tax applies to: prescribed drugs and medicine; insulin; and analgesics.

Drugs and medicine are exempt if they are sold only by prescription or if they are prescribed by a physician. Nonprescription analgesics are exempt if they consist principally of aspirin, acetaminophen, or ibuprofen.

An exemption for all drugs and medicine, whether prescription or nonprescription, was part of the original sales and use tax law enacted in 1967. In 1987 the exemption was limited to prescribed drugs and medicine and to insulin. In 1988 qualifying nonprescription analgesics were again exempted.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$51,300,000	$55,600,000	$60,300,000

4.04 PRESCRIPTION EYEGLASSES

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

Sales of prescription eyeglasses and contact lenses are exempt from the sales and use tax.

This provision was enacted in 1967 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$15,300,000	$16,300,000	$17,500,000

4.05 THERAPEUTIC AND PROSTHETIC DEVICES

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

The sales of therapeutic and prosthetic devices are exempt from the Minnesota sales and use tax.

A therapeutic device must not only be useful in the preservation of health, but it must also serve to cure or heal. It must serve to alleviate human injury, illness, or disease, either directly or by administering a curative agent. Examples of exempt items are syringes, oxygen tents, vaporizers, hospital beds, and wheelchairs.

A prosthetic device must be used to replace an injured, diseased, or missing part of the human body, either temporarily or permanently.

This provision was enacted in 1967. In 1989 the exemption was expanded to include reusable finger pricking devices and blood glucose monitoring machines used in the treatment of diabetes.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$4,500,000	$4,900,000	$5,400,000

4.06 BABY CARE PRODUCTS

Minnesota Statutes, Section 297A.25, Subd. 8(3)

Lotion, oil, powder, and similar products that are used for babies are exempt from the sales and use tax.

This exemption was enacted as part of the original sales tax law in 1967.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$600,000	$600,000	$700,000

4.07 FEMININE HYGIENE ITEMS

Minnesota Statutes, Section 297A.25, Subd. 26

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

This exemption was enacted in 1981 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$2,000,000	$2,100,000	$2,200,000

4.08 PUBLICATIONS

Minnesota Statutes, Section 297A.25, Subd. 10

Publications regularly issued at least once every three months are exempt from the sales and use tax. Included in this exemption are newspapers, magazines, and journals, and also items such as seasonal catalogues, shoppers guides, advertising circulars, and loose leaf or similar type of service publications. Magazines sold over the counter are not included in the exemption.

This provision was included in the original sales and use tax in 1967. It was last changed in 1983 when magazines sold over the counter became taxable.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$39,000,000	$41,200,000	$43,800,000

4.09 MOTOR FUELS

Minnesota Statutes, Section 297A.25, Subd. 7(1)

The gross receipts from the sale of and storage, use, or consumption of petroleum products taxed under the motor fuels tax (Minnesota Statutes, Chapter 296) are exempt from the sales and use tax. The exemption applies to gasoline and special fuel for highway, aviation, marine, snowmobile, or all-terrain vehicle use.

This exemption was enacted in 1967 and was last changed in 1987.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$175,000,000	$178,400,000	$183,600,000

4.10 PETROLEUM PRODUCTS USED IN THE IMPROVEMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 297A.25, Subd. 7(2)

Gross receipts from the sale of petroleum products used in the improvement of agricultural land are exempt from the sales and use tax. Products qualifying for exemption are those used in constructing, maintaining, and repairing drainage ditches, tile drainage systems, grass waterways, water impoundment, and other erosion control structures.

This provision was enacted in 1985 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

4.11 USED MOTOR OIL

Minnesota Statutes, Section 297A.25, Subd. 38

The gross receipts from the sale of used motor oil are exempt from the sales and use tax.

This exemption was enacted in 1988 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$100,000	$100,000

4.12 CASKETS AND BURIAL VAULTS

Minnesota Statutes, Section 297A.25, Subd. 17

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

This provision was enacted in 1967 and has not been changed.

Approximately 35,000 deaths occur each year in Minnesota.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$3,900,000	$4,000,000	$4,000,000

4.13 ACCESSORY TOOLS

Minnesota Statutes, Section 297A.25, Subd. 9

As a general rule, machinery, equipment, tools, and implements used in industrial production are subject to the Minnesota sales and use tax. This provision exempts accessory tools, equipment, and other short-lived items which meet three criteria: are separate units detachable from machinery; are used to produce a direct effect on a product; and have an ordinary useful life of less than twelve months. Items exempt under this provision include drill bits, grinding and abrasive wheels, saw blades, printing plates, dies, jigs, taps, patterns, and molds.

This exemption was enacted in 1973 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$14,000,000	$14,500,000	$14,900,000

4.14 CONSTRUCTION MATERIALS OR EQUIPMENT (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(1)

An exemption from the sales and use tax may be authorized by the commissioner of Revenue 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. Restrictions apply to the type of facility which is eligible for the exemption.

This provision was enacted in 1983 and was last changed in 1987. This exemption, along with the enterprise zone program, is scheduled to expire on December 31, 1996.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	*	*

4.15 REPAIR AND REPLACEMENT PARTS FOR FARM MACHINERY

Minnesota Statutes, Section 297A.25, Subd. 29

Repair and replacement parts, except tires, used for maintenance or repair of farm machinery are exempt from the sales and use tax. To qualify, the part must replace a farm machinery part assigned a specific or generic part number by the manufacturer of the machinery.

This exemption was enacted in 1985. In 1987 the definition of farm machinery was expanded to include sod-harvesting machinery and dealer-installed equipment.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$6,000,000	$6,200,000	$6,400,000

4.16 PERSONAL PROPERTY BROUGHT INTO MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 32

When individuals or businesses move into Minnesota, 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 are reduced by the amount of sales tax paid to other states as explained in Item 4.57.

*Less than $50,000

This provision was enacted in 1967 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$6,700,000	$6,800,000	$7,100,000

4.17 PACKING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 6

Sales of packing materials used to pack and ship household goods are exempt from the sales and use tax. The ultimate destination of the goods must be outside Minnesota, and the goods must not be returned to Minnesota except in the course of interstate commerce.

This exemption was enacted in 1973 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

4.18 PROPERTY FOR BUSINESS USE OUTSIDE MINNESOTA

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

The sale and delivery of personal property to a purchaser in Minnesota, who subsequently transports it outside the state before using it, is exempt from the sales and use tax if one of the following conditions is met:

1. the item is used for business and is not subject to the sales tax in the state or country to which it is transported; or
2. the property is repair or replacement parts to be used in the other state or country as part of a maintenance contract.

This provision was enacted in 1967 and was last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

4.19 ADVERTISING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 22

Generally, when a purchaser takes possession and stores tangible personal property in Minnesota, the transaction is subject to the sales and use tax, even if the purchaser ships the items for use outside the state. However, an exemption applies to the sale of advertising and promotional materials which are stored in Minnesota and subsequently shipped out of state by the purchaser for use outside Minnesota. Mailing and reply envelopes and cards used exclusively in connection with the advertising and promotional materials are included in the exemption.

This exemption was enacted in 1973 and was extended to mailing and reply envelopes and cards in 1985.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,000,000	$1,000,000	$1,000,000

4.20 RESOURCE RECOVERY EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 28

The gross receipts from the sale of equipment used to process solid or hazardous waste at a qualifying resource recovery facility are exempt from the sales and use tax.

This provision was enacted in 1984 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$300,000	$400,000	$4,800,000

4.21 YMCA AND YWCA MEMBERSHIP DUES

Minnesota Statutes, Section 297A.25, Subd. 37

Generally, the sales tax applies to the granting of membership in a club or association that provides sports and athletic facilities to its members, including one-time initiation fees and periodic membership dues. However, such initiation fees and periodic membership dues to the YMCA and YWCA are exempt. The exemption does not apply to separate charges made for using the association's sports and athletic facilities.

Prior to 1987, membership dues paid to country clubs, tennis clubs, or other similar clubs were also exempt. In 1987, when the sales tax was imposed on memberships to clubs providing sports and athletic facilities, the exemption for the YMCA and YWCA was enacted. It was clarified and recodified in 1988.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$900,000	$900,000	$900,000

4.22 CROSS COUNTRY SKI PASSES

Minnesota Statutes, Section 297A.25, Subd. 39

Exempt from the Minnesota sales and use tax are cross country ski passes issued by the Minnesota Department of Natural Resources for use of public trails.

This exemption was enacted in 1988.

Approximately 58,000 individuals purchased cross country ski passes in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

4.23 SERVICES

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

The inclusion of services in the concept of the tax base for the sales tax is subject to debate. Although the primary focus of the sales tax has been tangible personal property, a number of services are taxable, and the trend has been to extend the sales tax to additional services. Estimates of the exemption of the services listed below are provided for purposes of information and illustration.

When the sales tax was enacted in 1967, some services were taxable, including local telephone service, gas and electric service, and preparing and serving meals. In 1987 the tax was extended to a number of services including: long distance telephone service; parking; laundry and dry cleaning; building and residential cleaning, maintenance and exterminating; detective and security services; pet grooming; and lawn and garden services. The tax was extended to solid waste collection and disposal services in 1989 and to private communication services in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,316,100,000	$1,426,300,000	$1,540,900,000

*Less than $50,000

	Fiscal Year Impact		
	1993 (000's)	1994 (000's)	1995 (000's)
Personal Services:			
Beauty Shops	$18,800	$20,000	$21,300
Barber Shops	2,500	2,700	2,900
Shoe Repair	500	500	600
Funeral Services	5,700	6,200	6,900
Miscellaneous Personal Services	3,000	3,200	3,400
Total	$30,500	$32,600	$35,100
Business Services:			
Advertising Agencies	$26,900	$29,100	$31,100
Consumer Credit Reporting, Mercantile Reporting, Adjustment, and Collection Agencies	10,900	11,700	12,600
Computer and Data Processing Services	77,300	83,400	89,200
Other Business Services	83,300	89,900	96,100
Total	$198,400	$214,100	$229,000
Legal Services (Total)	$90,900	$98,600	$106,400
Engineering, Architectural, and Surveying Services (Total)	$52,800	$57,300	$61,800
Accounting Services (Total)	$42,500	$46,100	$49,800
Research, Development and Testing Services (Total)	$12,900	$14,000	$14,900
Management and Public Relations Services (Total)	$50,900	$54,900	$58,700
Scientific Consulting Services (Total)	$8,800	$9,500	$10,100
Automotive Repair and Maintenance Services (Total)	$62,200	$66,400	$70,800
Miscellaneous Repair Services (Total)	$19,800	$21,100	$22,500
Social Services:			
Child Day Care Services	$19,600	$21,100	$22,700
Individual and Family Social Services	26,400	28,400	30,500
Job Training and Rehabilitation Services	12,500	13,400	14,500
Residential Care Services	19,500	20,900	22,500
Total	$78,000	$83,800	$90,200

	Fiscal Year Impact		
	1993 (000's)	1994 (000's)	1995 (000's)
Health Services:			
Physicians	$150,500	$165,500	$181,700
Optometrists	4,700	5,100	5,500
Dentists	49,400	53,200	56,800
Chiropractors	11,400	12,200	13,100
Hospitals and Surgical Centers	223,700	247,100	272,300
Nursing and Personal Care Facilities	48,400	52,100	56,200
Specialty Hospitals and Facilities	49,700	53,300	57,100
Other Health Practitioners	1,400	1,500	1,700
Veterinarians	5,000	5,400	5,800
Total	$544,200	$595,400	$650,200
Selected Education Services:			
Private Elementary and Secondary Schools	$6,700	$7,200	$7,600
Colleges, Universities, and Professional Schools	68,000	72,400	77,400
Private Vocational and Other Schools	2,600	2,700	2,800
Total	$77,300	$82,300	$87,800
Transportation Services:			
Taxi Services	$10,700	11,400	12,100
Local Transit Services	2,800	2,800	2,800
Courier Services (Except Air)	21,200	22,900	24,600
Travel Agencies and Tour Operators	12,200	13,100	14,100
Total	$46,900	$50,200	$53,600

4.24 SEWER SERVICES

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

The furnishing of sewer services is exempt from the Minnesota sales and use tax.

Sewer service has never been subject to the sales and use tax.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$23,300,000	$24,100,000	$25,100,000

4.25 RESIDENTIAL WATER SERVICES

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

The furnishing of water for residential use is specifically exempt from the Minnesota sales and use tax.

This provision was enacted in 1979 and has remained unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$13,300,000	$13,900,000	$14,400,000

4.26 RESIDENTIAL HEATING FUELS

Minnesota Statutes, Section 297A.25, Subd. 23

Generally, the furnishing of fuel or energy for use or consumption within Minnesota is a taxable sale. This provision, however, exempts from the sales and use tax all fuel oil, coal, wood, steam, hot water, propane gas, and liquified petroleum gas sold to residential customers for residential use. Also, purchases of natural gas or electricity by residential customers who use natural gas or electricity for their primary source of residential heat are exempt for the six billing months of November through April.

This provision was enacted in 1978 and was expanded in 1984 to include hot water heat sold for residential use.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$79,500,000	$85,500,000	$91,500,000

4.27 CERTAIN INTERSTATE TELEPHONE SERVICE

Minnesota Statutes, Section 297A.25, Subd. 36

Charges for telephone service, including long distance service, are subject to the sales tax. However, exemptions apply in two situations:

- WATS (wide area telephone service) calls made from outside Minnesota to an individual or business in Minnesota at no toll charge to the person making the call.

- Charges paid by a qualified telemarketing firm that entitle it to make an unlimited number of long distance calls from a location in Minnesota to outside the state. To qualify, a telemarketing firm must derive at least 80% of its revenue from soliciting or providing information, soliciting sales or receiving orders, or conducting research. A company selling its own product does not qualify.

Prior to 1987, all interstate long distance telephone service was exempt from the sales tax. In 1987 the general exemption was removed, and the exemption for incoming WATS calls was enacted. The exemption for telemarketing firms was enacted in 1990.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$2,600,000	$2,700,000	$2,900,000

4.28 USED MANUFACTURED HOMES

Minnesota Statutes, Section 297A.25, Subd. 27

The sale of a manufactured home to be used as a residence is exempt from the sales and use tax unless it is the first retail sale of the home in Minnesota.

Generally, the sale of a manufactured home for residential use in Minnesota is taxed at 65% of the sales price (Item 4.59). The estimates measure the difference between the exemption and taxation at 65% of the sales price.

This provision was enacted in 1984.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$600,000	$600,000	$600,000

4.29 PHOTOVOLTAIC DEVICES

Minnesota Statutes, Sections 216C.06, Subd. 3 and 297A.25, Subd. 47

The gross receipts from the sale of photovoltaic devices and the materials used to install, construct, repair, or replace them are exempt from the sales and use tax if the devices are used as an electric power source.

The term "photovoltaic device" is defined as a system of components that generates electricity from incident sunlight by means of the photovoltaic effect, whether or not the device is able to store the energy produced for later use.

This exemption was enacted in 1992 and is effective for sales made from July 1, 1992, to June 30, 1996.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$100,000	$100,000

4.30 WIND ENERGY CONVERSION SYSTEMS

Minnesota Statutes, Sections 297A.25, Subd. 48

The gross receipts from the sale of wind energy conversion systems and the materials used to manufacture, install, construct, repair, or replace them are exempt from the sales and use tax if the systems are used as an electric power source. Wind energy conversion systems include any device which converts wind energy to a form of usable energy, such as a wind charger, windmill, or wind turbine.

The estimates do not include purchases that would qualify under the capital equipment exemption, Item 4.36.

This exemption was enacted in 1992 and is effective for sales made from July 1, 1992, to June 30, 1996.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$200,000	$300,000

4.31 AIR COOLING EQUIPMENT

Minnesota Statutes, Sections 297A.25, Subd. 49

The gross receipts from the sale of air cooling equipment are exempt if the equipment is purchased for conversion or replacement of an existing groundwater based once-through cooling system as required under Minnesota law (Section 103G.271, Subd. 5). Existing groundwater based once-through cooling systems using in excess of five million gallons annually must be terminated and converted or replaced by the end of their design life but not later than the year 2010.

This exemption was enacted in 1992, effective July 1, 1992.

Present law requires 95 permit holders to change their air conditioning systems before the year 2010, of which 46 are scheduled to occur in fiscal year 1995.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	$1,100,000

*Less than $50,000

4.32 LARGE SHIPS

Minnesota Statutes, Section 297A.25, Subd. 45

The gross receipts from the sale of, and use, storage, or consumption of, vessels with a gross registered tonnage of at least 3,000 tons are exempt from the sales and use tax.

This exemption was enacted in 1992 and was effective retroactive to all open tax years.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$100,000	$100,000

EXEMPTIONS - SALES TO PARTICULAR GROUPS

4.33 CERTAIN SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Sections 297A.25, Subd. 11

The gross receipts from the sale of tangible personal property and utility services to Minnesota school districts and to hospitals and nursing homes owned and operated by political subdivisions are exempt from the sales and use tax.

Specified sales to public libraries are also exempt, but the exemption is limited to books, periodicals, audio-visual materials and equipment, photocopiers for public use, and cataloging and circulation equipment and software. Public libraries must pay the tax on utility services and other purchases, such as shelves and furniture.

A general exemption for all local governments was part of the original sales tax law enacted in 1967. In 1992 the general exemption was repealed and the specific exemptions listed above were enacted, effective June 1, 1992.

	Fiscal Year Impact		
	1993	1994	1995
School Districts	$31,600,000	$33,300,000	$35,000,000
Hospitals	7,200,000	7,400,000	7,600,000
Nursing Homes	800,000	800,000	900,000
Libraries	900,000	1,000,000	1,000,000
Total - All Funds	$40,500,000	$42,500,000	$44,500,000

4.34 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 16

The sale of tangible personal property and utilities to charitable, religious, or educational organizations is exempt from the sales and use tax. To qualify for exemption, the property must be used in the performance of the organization's charitable, religious, or educational functions. Nonprofit senior citizens' groups are also included in the exemption.

The estimates below do not include: sales to local governments, Item 4.33; sales to veterans' organizations, Item 4.35; or the purchase of items such as food and motor fuels which are exempt under other provisions of the law.

This provision was included in the sales and use tax when it was enacted in 1967. In 1983 the exemption was extended to the purchase of utilities, and in 1989 the leasing of motor vehicles was excluded from the exemption.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$34,700,000	$35,800,000	$37,000,000

4.35 SALES TO VETERANS' ORGANIZATIONS

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

Purchases of tangible personal property and the storage, use, or consumption of such property by an organization of military service veterans or an auxiliary unit are exempt from taxation provided: the group is organized in Minnesota and is exempt from income taxes under federal law; and the property is used for charitable, civic, educational, or nonprofit purposes and not for social, recreational, pleasure, or profit purposes.

This provision was enacted in 1980 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

4.36 CAPITAL EQUIPMENT SOLD TO NEW OR EXPANDING INDUSTRIES

Minnesota Statutes, Sections 297A.01, Subd. 16, 297A.15, and 297A.25, Subd. 42

Certain capital equipment and machinery purchases are exempt from the sales and use tax. In order to qualify, the capital equipment, and the materials necessary to construct and install it, must be used by the purchaser or lessee to establish or expand a manufacturing, fabricating, mining, quarrying, or refining facility in the state. This exemption does not extend to: equipment purchased as replacements; replacement or repair parts; or machinery or equipment used to receive or store raw materials.

This exemption was enacted in 1989 and replaced the reduced rate of 4% that had applied to capital equipment used in new or expanding industries since 1984. In 1990 the exemption was extended to include mining and quarrying.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$19,200,000	$22,200,000	$24,200,000

4.37 TACONITE PRODUCTION MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 15

The gross receipts from the sale of and the storage, use, or consumption by taconite mining companies of mill liners, grinding rods, and grinding balls are exempt from the sales and use tax. To qualify, the items must be substantially consumed in the production of taconite, and the material of the items must be added to and become a part of the product being processed.

The estimates do not include items that would qualify under the exemption for accessory tools (Item 4.13) or as sales for resale in that they become part of the final product.

This exemption was enacted in 1971.

Seven taconite companies are currently operating in Minnesota.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

4.38 AIRFLIGHT EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 14

The gross receipts from the sales of airflight equipment to airline companies taxed under the airflight property tax are exempt from the sales and use tax. Airflight equipment includes airplanes, communications and navigational equipment, flight simulators, and parts necessary for the repair and maintenance of airflight equipment.

This exemption was enacted in 1967 and was last changed in 1971.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$5,900,000	$10,100,000	$8,900,000

4.39 AIRCRAFT FACILITY MATERIALS, EQUIPMENT, AND SUPPLIES

Minnesota Statutes, Section 297A.2571

Materials, equipment, and supplies used or consumed in constructing, or incorporated into the construction of, a heavy maintenance facility for aircraft or an aircraft engine repair facility are exempt from the sales and use tax. Except for equipment owned or leased by a contractor, the exemption also includes all machinery, equipment, and tools necessary to construct and equip that facility.

To qualify, the heavy maintenance facility must be owned by the State of Minnesota or one of its political subdivisions and leased by an airline company. The aircraft engine repair facility must meet the specifications described in Minnesota Statutes, Section 116R.02, Subd. 6. The specifications include that the facility is located in the city of Hibbing and that the construction of the facility is financed with the specified bonding authority.

This exemption was enacted in 1991 as part of a financing package for construction of a heavy maintenance facility in Duluth and a jet engine repair facility in Hibbing. The estimates are based on the tentative construction schedule available at the time of publication.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$0	$3,300,000	$11,100,000

4.40 REPAIR AND REPLACEMENT PARTS FOR SHIPS AND VESSELS

Minnesota Statutes, Section 297A.25, Subd.45

The gross receipts from the sales of lubricants and repair, replacement, and rebuilding parts and materials for ships or vessels used principally in interstate or foreign commerce are exempt from the sales and use tax.

This exemption was enacted in 1990, retroactive to January 1, 1984. In 1991 the retroactive effective date was changed to January 1, 1983.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

4.41 CONSTRUCTION MATERIALS FOR RECYCLING FACILITIES

Minnesota Statutes, Section 297A.25, Subd. 50

Construction materials and supplies are exempt from the sales and use tax if: 1) they are used or consumed in constructing a new facility which reduces the flow of solid waste by creating a market for recycled office waste; 2) the recycling process produces pulp or paper from high-grade office waste; and 3) the total capital investment made within a four-year period for construction of the facility exceeds $50 million.

The exemption applies regardless of whether the purchases are made by the owner, contractor, subcontractor, or builder.

This provision was enacted in 1992, effective for sales made from April 25, 1992, to March 31, 1994.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$0	$800,000	$0

4.42 SALES TO FARMERS FOR CONSERVATION PROGRAMS

Minnesota Statutes, Section 297A.25, Subd. 9

The gross receipts from the sale of seeds, trees, fertilizers, and herbicides to farmers for use in specified conservation programs are exempt from the sales and use tax. Under these programs, farmers agree to keep farmland out of production. The set-aside acres are required to be planted with cover crops, and the farmers are reimbursed by the federal or state government for a portion of the costs involved.

Purchases relating to three federal programs qualify for this exemption: the Conservation Reserve Program; the Integrated Farm Management Program; and the Wheat and Feed Grain Program. The state program under which purchases are eligible for the exemption is the conservation reserve program established under the Reinvest in Minnesota Resources Law (RIM).

This provision was enacted in 1991, retroactive to January 1, 1989.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$800,000	$800,000	$800,000

4.43 SALES OF TEXTBOOKS TO STUDENTS

Minnesota Statutes, Section 297A.25, Subd. 21

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 a public or private school, college, university, business, or trade school.

This provision was enacted in 1973 and has not been changed.

The main beneficiaries of this provision are post-secondary students, of which there were approximately 273,000 in Minnesota in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$5,500,000	$6,100,000	$6,800,000

4.44 SALES OF BUILDING MATERIALS TO DISABLED VETERANS

Minnesota Statutes, Section 297A.25, Subd. 20

The sales of building materials used in constructing or remodeling a disabled veteran's residence are exempt from the sales and use tax if the project is financed in whole or in part by the U.S. Government in accordance with United States Code, Title 38, Sections 801 to 805.

This exemption was enacted in 1971 and has not been changed.

Fewer than ten claims for refund are filed annually under this provision.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

4.45 SALES OF CHAIR LIFTS, RAMPS, AND ELEVATORS FOR DISABLED PERSONS' HOMESTEADS

Minnesota Statutes, Section 297A.15, Subd. 6 and 297A.25, Subd. 43

The sales of chair lifts, ramps, and elevators and the building materials used to install or construct them are exempt from the sales and use tax if they are authorized by a physician and installed in or attached to the owner's homestead.

This exemption was enacted in 1989, effective January 1, 1990.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

4.46 AMBULANCES LEASED TO LICENSED AMBULANCE SERVICES

Minnesota Statutes, Section 297A.25, Subd.44

The lease of a motor vehicle for use as an ambulance by a licensed ambulance service is exempt from the sales and use tax. The provision includes both public and private ambulance services.

Although the sale of a motor vehicle comes under the motor vehicle excise tax (Chapter 5), the lease of a motor vehicle is within the jurisdiction of the sales tax.

This provision was enacted in 1990.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

EXEMPTIONS - SALES BY PARTICULAR GROUPS

4.47 ISOLATED OR OCCASIONAL SALES

Minnesota Statutes, Section 297A.25, Subd. 12

Although 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. Also exempt is the storage, use, or consumption of property acquired as a result of such a sale.

*Less than $50,000

The exemption applies to all isolated or occasional sales of property not used in a trade or business, except for aircraft. The isolated or occasional sale exemption does not apply to tangible personal property used in a trade or business unless certain conditions exist.

The isolated or occasional sale of property used in a trade or business is taxed unless the sale comes under one of these categories: sales of farm machinery; farm auction sales; sale of substantially all of the assets of a trade or business; and sales not exceeding $1,000 in a twelve-month period. Also exempt are sales that occur in transactions covered in several Internal Revenue Code sections, such as contributions to capital, certain liquidations, and involuntary conversions.

The isolated or occasional sale exemption was enacted in 1967. In 1991 property used in a trade or business was eliminated from the general exemption, except for transactions covered under specified Internal Revenue Code sections. In 1992 the exemption was reinstated for farm machinery and the other exceptions listed above, retroactive to July 1, 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$20,000,000	$21,500,000	$23,000,000

4.48 INSTITUTIONAL MEALS

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

Although the gross receipts from the sale of prepared meals and drinks are generally subject to the sales tax, the following are exempt:

1. Meals and drinks served to patients, residents, or inmates of hospitals, nursing homes, sanitariums, senior citizens' homes, and correctional, detention, and detoxification facilities.
2. Meals served at public and private schools, universities, and colleges, including food sold through vending machines.
3. Congregate dining, home delivery of meals, and other qualifying programs which provide meals to senior citizens or the handicapped.

This provision was enacted as part of the sales and use tax law in 1967. It was last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$27,300,000	$28,100,000	$29,000,000

4.49 FUNDRAISING SALES BY NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.256

Sales made by nonprofit organizations are taxable unless specifically exempted by statute. An exemption from the sales tax does apply to certain fundraising sales made by nonprofit organizations.

The exemption applies to:

1. Fundraising sales by an organization that: a) is an educational or social organization for people age eighteen and under or is a senior citizen group that is exempt from the sales tax; and b) has gross annual receipts from fundraising that do not exceed $10,000.

2. Sales, including personal property, admission charges, food, meals, and drinks at fundraising events sponsored by a nonprofit organization when the entire proceeds, except necessary expenses, go exclusively for charitable, religious, or educational purposes. This exemption does not apply to bingo or other gambling activities. The exemption is limited to no more than 24 days a year.

This provision was enacted in 1985 and was last changed in 1988.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$2,900,000	$3,000,000	$3,000,000

4.50 CANDY SALES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 2(1)

Candy and candy products are exempt from the sales tax when sold for fundraising purposes by a nonprofit organization which provides educational and social activities for young people age eighteen and under.

This exemption was enacted in 1984 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

4.51 ADMISSION TO SCHOOL-SPONSORED EVENTS

Minnesota Statutes, Section 297A.25, Subd. 30

The gross receipts from the sale of tickets or admissions to regular season school games, events, and activities of elementary and secondary schools are exempt from the sales and use tax. The estimates do not include sales of tickets that would be exempt as admission to artistic events (Item 4.52) or under the fundraising exemption (Item 4.49).

This exemption was enacted in 1985.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$600,000	$600,000	$600,000

4.52 ADMISSION TO ARTISTIC EVENTS

Minnesota Statutes, Section 297A.25, Subd. 24

The gross receipts from the sale of tickets or admissions to events which provide opportunities for participation in the creation, performance, or appreciation of the arts are exempt from the sales tax if the events are sponsored by a tax-exempt organization or a municipal board which promotes cultural events.

This exemption was enacted in 1980 and was extended to municipal boards in 1992.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,400,000	$1,400,000	$1,400,000

4.53 SACRAMENTAL WINE

Minnesota Statutes, Section 297A.25, Subd. 46

The gross receipts from the sale of wine for sacramental purposes in religious ceremonies are exempt from the sales and use tax if the wine is purchased from a nonprofit religious organization or the holder of a sacramental wine license.

This exemption was enacted in 1991, retroactive to January 1, 1988.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

REDUCED RATES

4.54 TWO AND ONE-HALF PERCENT RATE FOR FARM MACHINERY

Minnesota Statutes, Sections 297A.01, Subd. 15 and 297A.02, Subd. 2

The sales and use tax rate applicable to the sales of farm machinery is 2.5%, rather than the general rate of 6.5%. Qualifying farm machinery includes machinery, equipment, implements, accessories, and contrivances used in the production for sale, but not processing, of agricultural products. Also qualifying for the lower rate is irrigation equipment purchased as an irrigation system.

Logging equipment is also subject to the lower rate but is estimated separately in Item 4.55. The exemption of farm machinery repair and replacement parts is estimated separately in Item 4.15.

A 4% rate for farm machinery was enacted in 1981 when the general sales and use tax rate was raised from 4% to 5%. In 1985 the rate on farm machinery was reduced from 4% to 2%. The rate became 2.5% upon adoption by all counties of the 0.5% local option sales tax authorized by a 1991 law. In 1987 the lower rate was extended to sod-harvesting machinery and to dealer-installed equipment, whether or not it becomes part of real property. The lower rate was extended to generators in 1990 and to aquaculture equipment in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$17,500,000	$17,900,000	$18,300,000

4.55 TWO AND ONE-HALF PERCENT RATE FOR LOGGING EQUIPMENT

Minnesota Statutes, Sections 297A.01, Subd. 15 and 297A.02, Subd.2

Logging equipment is subject to a 2.5% sales and use tax rate, rather than the general 6.5% rate. Chain saws used for commercial logging are included in logging equipment that qualifies for the lower rate.

The reduced rate for logging equipment was enacted in 1984 at 4% and in 1985 it was reduced to 2%. The rate became 2.5% upon adoption by all counties of the 0.5% local option sales tax authorized by a 1991 law.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

4.56 FOUR AND ONE-HALF PERCENT RATE FOR SPECIAL TOOLING

Minnesota Statutes, Sections 297A.01, Subd. 17 and 297A.02, Subd. 2

Special tooling, 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", is subject to a 4.5% sales and use tax rate rather than the general 6.5% rate. To qualify for the reduced rate, items must be special ordered and produced in accordance with buyer specifications. Items purchased from inventory or ordered from a catalog or other sales literature do not qualify.

Special tools that qualify for the accessory tool exemption in Item 4.13 are included in that estimate and are not included herein.

The reduced rate for special tooling was enacted in 1984.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$900,000	$1,000,000	$1,000,000

4.57 TAX PAID TO OTHER STATES

Minnesota Statutes, Section 297A.24

If a sales or use tax has previously been paid on an article of tangible personal property to another state at a rate lower than the Minnesota rate, then the Minnesota rate applicable to that article is the difference between the Minnesota rate and the other state's rate. If the other state's rate is equal to or higher than Minnesota's rate, no Minnesota sales and use tax is imposed.

This provision was enacted in 1967 and was last changed in 1981.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,200,000	$1,200,000	$1,200,000

REDUCED SALES PRICE

4.58 PRICE REDUCED BY VALUE OF TRADE IN

Minnesota Statutes, Section 297A.01, Subd. 8
Minnesota Rules, Part 8130.1500

The sales price is reduced by any amount allowed as credit for tangible personal property taken in trade for resale. To qualify for the reduction in sales price, the property must be taxable under the sales and use tax or the motor vehicle excise tax and of the type of property normally sold in the regular course of the retailer's business.

This provision was enacted in 1967 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$5,800,000	$5,900,000	$6,100,000

4.59 NEW MANUFACTURED HOMES

Minnesota Statutes, Section 297A.02, Subd. 4

The sale in Minnesota of a manufactured home used as a residence is taxed at 65% of the sales price. The estimates measure the difference between application of the tax on the full sales price and 65% of the sales price.

This provision applies only to the first sale of a manufactured home in the state because an exemption applies to any subsequent sale. The exemption for used manufactured homes is estimated separately in Item 4.28.

This provision was enacted in 1984.

Approximately 1,300 manufactured homes are shipped to Minnesota dealers annually.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,000,000	$1,000,000	$1,000,000

CHAPTER 5: MOTOR VEHICLE EXCISE TAX

Collections and History

Total revenues from the motor vehicle excise tax were $270 million in fiscal year 1992. Prior to fiscal year 1985, all revenues from this tax went into the state general fund. The distribution of the receipts was modified a number of times since then, with varying portions going for highways and transit assistance. Beginning July 1, 1991, the revenues from the 0.5% county option tax plus 1.5% of the 6% state rate go into the local government trust fund (30.77%), with the remainder (69.23%) going to the state general fund.

Motor vehicles were subject to the general sales tax when it was enacted in 1967. The sales tax on motor vehicles was replaced by the motor vehicle excise tax during the 1971 legislative session.

When the tax became effective on January 1, 1972, the rate was 4%. The rate was increased to 5% on July 1, 1981, and to 6% on July 1, 1983. A county local option tax of 0.5% was authorized by the 1991 Legislature, and all 87 counties have adopted it. Therefore, the general statewide tax rate is 6.5%.

Note: Throughout Chapters 4 and 5, the combined state and local rate of 6.5% is used, without separate references to the state rate portion and the county option portion. The fiscal impact of the tax expenditures is not shown separately for the state general fund and the local government trust fund but is available for any item upon request.

Tax Base

The tax base for the motor vehicle excise tax is the purchase price of a motor vehicle when ownership is transferred and the motor vehicle is required to be registered under the laws of Minnesota. Regardless of the number of times a vehicle is sold, each transfer of ownership is in the tax base. The transfer of a motor vehicle to a dealer for resale in the regular course of business is not within the base. For a vehicle transferred by gift or for a nominal or no monetary consideration, the purchase price is deemed to be the average value of similar motor vehicles.

Computation of the Tax

The motor vehicle excise tax is imposed when a motor vehicle required to be registered in Minnesota is purchased or acquired, either in or outside Minnesota. The 6.5% rate is applied to the purchase price, which is defined as the total consideration valued in money, whether paid in money or otherwise. When one motor vehicle is taken in trade on another vehicle, the trade-in value is deducted in arriving at the net purchase price. In the case of a gift or a transfer for a nominal or no monetary consideration, the average value of similar motor vehicles is used as the purchase price.

The tax is paid to the motor vehicle registrar, and it must be paid before registration plates or a certificate of title can be issued.

EXEMPTIONS

5.01 VEHICLES ACQUIRED BY INHERITANCE

Minnesota Statutes, Section 297B.01, Subd. 7(a)

The acquisition of a motor vehicle by inheritance or by bequest of a decedent is exempt from the motor vehicle excise tax.

This provision was enacted in 1971 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,800,000	$1,900,000	$1,900,000

5.02 VEHICLES OF PERSONS MOVING INTO MINNESOTA

Minnesota Statutes, Section 297B.03(2)

When a person moves to Minnesota and establishes residency, any motor vehicle owned by that person which was purchased and titled in another state more than sixty days prior to the move is exempt from the Minnesota motor vehicle excise tax.

This provision was enacted in 1971 and remains substantially unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$5,300,000	$5,600,000	$5,800,000

5.03 TRANSFERS BETWEEN JOINT OWNERS

Minnesota Statutes, Section 297B.01, Subd. 7(b)

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. Without this exemption, the tax on the transfer of a motor vehicle without monetary consideration would be based on the average value of similar vehicles.

This provision has not been changed since its enactment in 1971.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,800,000	$1,900,000	$1,900,000

5.04 TRANSFERS BETWEEN SPOUSES OR PARENTS AND CHILDREN

Minnesota Statutes, Section 297B.01, Subd. 7(c) and 8

Any transfer of a vehicle in the form of a gift 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 average value of similar vehicles, this provision is a tax expenditure.

This exemption was enacted in 1971 and was last changed in 1974.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$8,300,000	$8,600,000	$8,900,000

5.05 TRANSFERS IN DIVORCE PROCEEDINGS

Minnesota Statutes, Section 297B.01, Subd. 7(d)

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 (Item 5.03), the estimates below include only those transfers involving a vehicle previously registered to one person.

This provision was enacted in 1974 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$1,200,000	$1,300,000	$1,500,000

5.06 CORPORATE AND PARTNERSHIP TRANSFERS

Minnesota Statutes, Section 297B.03(4)

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.

This provision was enacted in 1975 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

5.07 SALES TO DISABLED VETERANS

Minnesota Statutes, Section 297B.03(1)

Disabled veterans who purchase motor vehicles with funds provided either in whole or in part by the Veterans Administration under the provisions of 38 United States Code, Section 1901, are not required to pay any motor vehicle excise tax.

This provision was enacted in 1971 and has not been revised since that time.

Twenty vehicles were purchased under this program in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

5.08 VEHICLES USED IN AUTOMOTIVE TRAINING PROGRAMS

Minnesota Statutes, Section 297B.03(6)

The purchase or use of a motor vehicle by a public or a private nonprofit educational institution is exempt from the motor vehicle excise tax if the vehicle is used as an instructional aid in an automotive training program operated by the institution. Vehicles used for driver education programs do not qualify for this exemption.

Nearly all the vehicles that qualify for this exemption are donated to the institution. Although a transfer is made without monetary consideration, the tax would otherwise be imposed on the average value of similar vehicles.

This exemption was enacted in 1988. The purchase or use of these vehicles had previously been included under the general exemption for local government units and nonprofit organizations which was repealed in 1987.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

5.09 AMBULANCES PURCHASED BY PRIVATE AMBULANCE SERVICES

Minnesota Statutes, Section 297B.03(7)

The purchase of a motor vehicle for use as an ambulance by a privately-owned licensed ambulance service is exempt from the motor vehicle excise tax.

This provision was enacted in 1990.

Ambulances purchased by local units of government have always been exempt. The exemption of these purchases is not considered a tax expenditure because publicly-owned ambulances are not required to be registered and, therefore, are not in the tax base.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

REDUCED PURCHASE PRICE

5.10 FEDERAL EXCISE TAXES

Minnesota Statutes, Section 297B.01, Subd. 8

When computing the Minnesota motor vehicle excise tax, any federal taxes imposed on the retail sale of a vehicle are excluded from the purchase price. At the present time two federal excise taxes are levied upon new motor vehicles, and both are at the rate of 12% of retail price: trucks in excess of 33,000 pounds gross vehicle weight; and trailers or semitrailers in excess of 26,000 pounds gross vehicle weight.

This provision was enacted in 1983 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

*Less than $50,000

5.11 PRICE REDUCED BY VALUE OF TRADE IN

Minnesota Statutes, Section 297B.01, Subd. 8

When a motor vehicle is taken in trade as part payment on another motor vehicle, the selling price is reduced by the amount of trade-in value allowed. The 6.5% motor vehicle excise tax is applied to the reduced price. This provision applies both to dealer sales and to sales between individuals. The tax expenditure is the difference between the tax collected on the reduced purchase price and the tax that would be collected if imposed on the full purchase price.

The provision was enacted along with the motor vehicle excise tax in 1971.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$41,000,000	$42,300,000	$43,600,000

5.12 HANDICAPPED-ACCESSIBLE MODIFICATIONS

Minnesota Statutes, Sections 297B.01, Subd. 8

The motor vehicle excise tax is 6.5% of the purchase price of a new or used motor vehicle. However, the purchase price does not include the portion of the value of a motor vehicle due solely to modifications necessary to make the motor vehicle handicapped accessible.

This provision was enacted in 1992.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

*Less than $50,000

PREFERENTIAL COMPUTATIONS

5.13 FLAT TAXES ON OLDER CARS AND COLLECTOR VEHICLES

Minnesota Statutes, Section 297B.02, Subd. 2 and 3 and 297B.025

In lieu of the 6.5% motor vehicle excise tax, a flat tax of $10 is imposed on the transfer of a passenger automobile that is in at least its tenth year of vehicle life and has a resale value of less than $3,000.

A passenger automobile that is registered and licensed as a collector vehicle (pioneer, classic, collector, street rod, or collector military vehicle) is subject to a flat tax of $90 upon transfer of ownership, instead of being taxed at 6.5% of the purchase price. In order to be registered as a collector vehicle, several requirements must be met, including the type and age of the vehicle. Also, the vehicle must be owned and operated solely as a collector's item and not used for general transportation purposes.

Compared to a tax of 6.5% of the purchase price, the $10 flat tax is lower for an older car sold for $155 or more, and the $90 tax is lower for a collector vehicle sold for more than $1385.

The $10 flat tax on older cars was enacted in 1985. The $90 flat tax on collector vehicles was enacted in 1988 and was last changed in 1989 when it was extended to collector military vehicles.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$6,400,000	$6,600,000	$6,800,000

CREDIT

5.14 CREDIT FOR TAXES PAID TO OTHER STATES

Minnesota Statutes, Section 297B.08

Minnesota allows a credit against the motor vehicle excise tax due at the time of vehicle registration for any sales, use, or excise tax paid on the vehicle to another state. The credit is allowed only if the other state has a similar provision allowing a credit for excise taxes paid in Minnesota.

Because vehicles purchased by nonresidents more than sixty days prior to moving into Minnesota are exempt (Item 5.02), this provision affects only purchases by nonresidents that occurred within the sixty days prior to the move and purchases by residents for any tax paid to another state.

This exemption was enacted in 1971 and was last changed in 1981.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$500,000	$500,000	$500,000

CHAPTER 6: HIGHWAY FUELS EXCISE TAXES

Collections and History

The net revenues from the taxes on highway gasoline and special fuels were $463 million in fiscal year 1992. All revenues from these taxes go into the highway user tax distribution fund.

Minnesota first imposed an excise tax on highway fuels in 1925 at a rate of 2¢ per gallon. Eleven rate increases have occurred since then. The current rate of 20¢ per gallon has been in effect since 1988.

In 1985 an annual alternate fuel permit fee was enacted for vehicles using compressed natural gas, to be imposed in lieu of the gasoline and special fuels taxes. In 1988 the permit was extended to propane, and in 1991 it was extended to include all vehicles propelled by any method other than gasoline or diesel fuel.

Tax Base

The tax base for the highway fuels excise taxes is motor fuel used in vehicles on Minnesota highways. Therefore, it is not considered a tax expenditure when the tax does not apply to off-road usage, such as for farming, or to out-of-state usage. The annual alternate fuel permit fee is intended to yield revenue equivalent to the per-gallon tax and is not considered preferential.

Computation of the Tax

The highway fuel tax rate is 20¢ per gallon and is imposed on gasoline and special fuels (diesel) used on Minnesota highways. Motor carriers based in states other than Minnesota pay the road tax which is 20¢ per gallon for gasoline or special fuel used on Minnesota highways. A person who purchases gasoline or special fuel in Minnesota and regularly drives in another state(s) may claim a refund for the tax paid on the fuel used in another state.

For gasoline, the distributor collects and remits the tax; for special fuel, the seller collects and remits the tax. A special fuel is defined as all combustible gases and liquid petroleum products or substitutes therefor, except gasoline.

Vehicles propelled by compressed natural gas, propane, or any other manner except gasoline or special fuel are subject to an annual alternate fuel permit fee in lieu of gasoline or special fuels taxes. The fee is based on the vehicle's weight and mileage driven within Minnesota in the preceding year and is paid annually to the Department of Public Safety.

EXEMPTIONS

6.01 TRANSIT SYSTEMS RECEIVING STATE FINANCIAL ASSISTANCE

Minnesota Statutes, Sections 296.02, Subd. 1a and 296.025, Subd. 1a

The highway fuels excise taxes are not imposed on gasoline and special fuel purchased by a transit system that receives state financial assistance through the Regional Transit Board (seven-county metropolitan area) or the Public Transit Subsidy Program (outside the metropolitan area).

An exemption for transit systems owned by local governments was enacted in 1977. In 1990 the qualification for the exemption was extended to all systems receiving state financial assistance.

Twenty-seven transit systems qualified for this exemption in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$2,100,000	$2,100,000	$2,100,000

6.02 MOTOR VEHICLES NOT REQUIRING REGISTRATION (SPECIAL FUELS)

Minnesota Statutes, Sections 168.012, Subd. 1 and 296.18, Subd. 1

The highway special fuels (diesel) tax is imposed on licensed motor vehicles, which are those requiring registration. Vehicles not requiring registration and therefore exempt from the special fuels tax include municipal fire apparatus, police patrols, and ambulances, the appearance of which is unmistakable. For example, an unmarked police car must be registered and is therefore not exempt.

This provision was enacted in 1951 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$600,000	$600,000	$600,000

CREDITS

6.03 GASOHOL (OTHER THAN FOR GOVERNMENTAL UNITS OR SCHOOL TRANSPORTATION)

Minnesota Statutes, Section 296.02, Subd. 7

Agricultural alcohol gasoline, commonly referred to as "gasohol", is a gasoline blend of up to 10% agriculturally derived fermentation ethanol. A credit is allowed to distributors equal to 20¢ per gallon of fuel grade alcohol blended with gasoline to produce gasohol. Because the blend is usually 10% ethanol, the credit is equivalent to a 2¢ per gallon reduction in the tax on gasohol. The credit must be passed on by the distributor to the retailer.

Preferential treatment for gasohol was first enacted in 1980 in the form of a reduced rate. The reduced rate was changed to a credit in 1985, and the current credit amount was adopted in 1986.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$9,400,000	$9,500,000	$9,600,000

6.04 GASOHOL FOR GOVERNMENTAL UNITS AND SCHOOL TRANSPORTATION

Minnesota Statutes, Section 296.02, Subd. 8

A credit of 80¢ per gallon of ethanol blended with gasoline to produce gasohol is allowed on gasohol sold to governmental units and for school transportation. The credit of 80¢ per gallon of ethanol is the equivalent of an 8¢ per gallon reduction in the tax on gasohol because the blend is nearly always 10% ethanol. This credit is in lieu of, not in addition to, the 20¢ per gallon credit explained in Item 6.03.

This provision was enacted in 1983 in the form of an 8¢ per gallon rate reduction for gasohol. The reduced rate was changed to a credit in 1985. In 1991 the requirement that the sale had to be "in bulk" was deleted.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$300,000	$300,000	$300,000

CHAPTER 7: ALCOHOLIC BEVERAGE TAXES

Collections and History

In fiscal year 1992, the revenues from the alcoholic beverage taxes were: $37.8 million from distilled spirits; $13.6 million from beer; and $3.2 million from wine. The total of $54.6 million was 0.7% of total state revenues. All revenues from these taxes are deposited in the state general fund.

An excise tax was first imposed on alcoholic beverages in Minnesota in 1934. The initial rates were: 60¢ per gallon for distilled spirits; $1 per barrel for 3.2% beer and $2 per barrel for strong beer; and wine rates ranging from 10¢ to 60¢ per gallon. The tax rates were increased (and occasionally decreased) at various times, and the current rates have been in effect since 1987.

Tax Base

The tax base for the alcoholic beverages taxes is alcoholic beverages for human consumption which are manufactured, imported, sold, or possessed in Minnesota. Therefore, the exemptions for alcohol used for purposes other than human consumption are not tax expenditures, such as the exemption for alcohol used in industrial production.

Computation of the Tax

The tax is paid by the wholesaler, distributor, or manufacturer upon acquisition for sale within Minnesota. The tax is based on volume, not price. Alcoholic beverages are also subject to a sales tax of 9% of the purchase price, compared to the general sales tax rate of 6.5%.

The tax rates are:

Beer: Alcohol by Weight	Tax per Barrel of 31 Gallons
3.2% or less	$2.40
More than 3.2%	$4.60

	Tax	
	Per Gallon	Per Liter
Distilled Spirits (includes liqueurs, cordials, and specialities, regardless of alcoholic content)	$5.03	$1.33
Wine: Alcohol by Volume		
14% or less	$.30	$.08
More than 14% to 21%	.95	.25
More than 21% to 24%	1.82	.48
More than 24%	3.52	.93
Sparkling Wine	1.82	.48

EXEMPTIONS

7.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Section 297C.09

Any person may bring into Minnesota the following quantities of alcoholic beverages from another state or country without paying the appropriate Minnesota excise tax: up to one liter of distilled spirits or wine or nine quarts of beer from another state; and up to four liters of distilled spirits or wine or ten quarts of beer from another country.

This provision was enacted in 1947 and was last changed in 1989.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

7.02 HOME PRODUCTION AND USE (WINE AND BEER)

Minnesota Statutes, Section 297C.07(3)

Beer naturally brewed and fruit juices naturally fermented in the home for family use are exempt from the alcoholic beverage taxes.

This exemption was first authorized by statute in 1957 and was last changed in 1985.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

7.03 SALES TO FOOD PROCESSORS AND PHARMACEUTICAL FIRMS

Minnesota Statutes, Section 297C.07(5)

Alcoholic beverages sold to authorized manufacturers of food products or pharmaceutical firms are exempt from the alcoholic beverage taxes. To qualify for the exemption, the alcoholic beverage must be used exclusively in the manufacture of food products or medicines.

This exemption had been allowed administratively prior to being codified in 1988.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

7.04 CONSUMPTION ON BREWERY PREMISES (BEER)

Minnesota Statutes, Section 297C.07(4)

Beer that is served by a brewery at no charge for on-premise consumption or is distributed to brewery employees for on-premise consumption under a labor contract is exempt from the Minnesota excise tax.

This provision was enacted in 1941 and was last changed in 1985.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

7.05 WINE FOR TASTING AND TESTING

Minnesota Statutes, Section 297C.03

The excise tax imposed on the production of wine in Minnesota exempts wine which is used for tasting and testing purposes.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

7.06 WINE FOR SACRAMENTAL PURPOSES

Minnesota Statutes, Sections 297C.07(2)

Sales of wine exclusively for sacramental purposes to a minister, rabbi, or priest of a church or established religious organization are not subject to the Minnesota excise tax.

This provision was adopted in 1937 and was last changed in 1985.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

*Less than $50,000

CREDIT

7.07 SMALL BREWERS' CREDIT (BEER)

Minnesota Statutes, Section 297C.02, Subd. 3

A credit is allowed to a brewer who manufactures less than 100,000 barrels of beer in the calendar year preceding the year for which the credit is claimed. The credit is $4.60 per barrel on 25,000 barrels sold in a fiscal year, with a maximum credit of the lesser of the brewer's tax liability or $115,000.

The credit was enacted in 1985 and was changed in 1988. A credit for beer produced and sold in Minnesota had been in effect from 1973 to 1985.

Seven breweries qualified for this credit in fiscal year 1992.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

CHAPTER 8: CIGARETTE AND TOBACCO TAXES

Collections and History

In fiscal year 1992, cigarette tax revenues were $156.5 million and tobacco products tax revenues were $7.8 million. The revenues from the cigarette tax are distributed as follows: debt service on specified bonds is paid first; 2¢ per pack to the Minnesota future resources fund; 5¢ per pack temporarily to the health care access fund (July 1, 1992, to December 31, 1993); and the balance to the state general fund. Revenues from the tobacco products tax go to the state general fund.

The cigarette tax was enacted in 1947 at a rate of 3¢ per pack. Several rate increases have occurred since then, with the most recent being to 43¢ in 1991 and to 48¢ in 1992. Cigarettes were first subject to the general sales tax in 1982.

The tobacco products tax was enacted in 1955 at a rate of 15% of the wholesale price. The rate was increased to 20% in 1959, to 25% in 1985, and to 35% in 1987. Tobacco products have been subject to the general sales tax since it was enacted in 1967.

Tax Base

The tax base is essentially the same for both the cigarette tax and the tobacco products tax. It is the sale of cigarettes or tobacco products in Minnesota. Also included in the tax base is the use or storage in Minnesota of cigarettes or tobacco products if the tax was not paid previously. Although the jurisdictional tax base is the same for both taxes, the cigarette tax is based on volume, and the tobacco tax is based on wholesale price.

Computation of the Tax

The cigarette tax is 48¢ per pack of twenty cigarettes. The tax is paid by the distributor by purchasing stamps that are affixed to the packages. The distributors receive a discount of 1% for the first $1.5 million of stamps purchased each year and 0.6% for stamps over $1.5 million purchased. A complementary use and storage tax of 48¢ per pack is imposed on cigarettes that are used or stored in Minnesota, on which the tax had not previously been paid (unstamped packages).

The tobacco products tax is 35% of the wholesale price. The tax is imposed on all tobacco products, except cigarettes, and includes cigars, smoking tobacco, and chewing tobacco. The tax is paid by the distributor, who receives a discount of 1.5% of the tax. A complementary use and storage tax of 35% of the cost is imposed on tobacco products that are used or stored in Minnesota, on which the tax had not previously been paid.

For both the cigarette and tobacco products taxes, the statutes state the tax ". . . shall not be construed as a cost of doing business or an overhead expense . . .". In all cases, the taxes are passed on to the consumer.

EXEMPTION

8.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Sections 297.22, Subd. 3 and 297.32, Subd.2

A use and storage tax equal to the cigarette tax is imposed on consumers in possession of cigarettes 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 if brought into Minnesota by the consumer. The exemption applies to: not more than 200 cigarettes; not more than fifty cigars; not more than ten ounces of snuff or snuff powder; and not more than one pound of smoking or chewing tobacco or other tobacco products not specifically mentioned in the statutes.

This exemption could be viewed as an incentive for consumers to purchase cigarettes and tobacco products in bordering states because they have lower rates. Minnesota's taxes on cigarettes and tobacco products are currently higher than the surrounding states.

State	Cigarette Tax Rate Per Pack of 20	Tobacco Products % of Wholesale Price
Minnesota	48¢	35%
Iowa	36¢	22%
North Dakota	29¢	22%
South Dakota	23¢	No tax
Wisconsin	38¢	20%

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 Year Impact		
	1993	1994	1995
Total - All Funds	$2,000,000	$2,100,000	$2,100,000

CHAPTER 9: MORTGAGE REGISTRY TAX

Collections and History

In fiscal year 1992, state revenues from the mortgage registry tax were $34.4 million. The tax is collected by each county. Three percent of the proceeds of the tax are deposited in the county revenue fund, and 97% goes to the state general fund.

Minnesota first enacted a mortgage registry tax in 1907 at a rate of 50¢ for each $100 of principal debt secured by a mortgage of real property. In 1945 the rate was changed to 15¢ for each $100 of such debt, and in 1987 the tax was increased to 23¢ for each $100 of principal debt.

Tax Base

The tax base is the amount of principal debt secured by a mortgage of real property within Minnesota. Only registered mortgages are within the tax base. Although similar to a mortgage in some respects, a contract for deed is not a mortgage because the debt is not secured by real property.

Computation of the Tax

The mortgage registry tax is 23¢ for each $100, or fraction thereof, of principal debt which is or may be secured by any mortgage of real property within Minnesota and which is recorded or registered. If the real estate used to secure the debt includes property outside Minnesota, the tax is applied to a proportion of the entire debt, the proportion being the value of the Minnesota real estate to the value of the entire real estate described in the mortgage.

The statutes do not specify who pays the mortgage registry tax. Generally, the lender records or registers the mortgage and pays the tax. The tax is paid to the county treasurer at or before the time of filing the mortgage for record or registration.

EXEMPTION

9.01 CERTAIN PERSONS AND ORGANIZATIONS

Minnesota Statutes, Section 287.06

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.

This provision was enacted in 1907 and was last revised in 1965.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$200,000	$200,000	$200,000

CHAPTER 10: DEED TRANSFER TAX

Collections and History

State revenues from the deed transfer tax were $29.1 million in fiscal year 1992. Each county collects the tax, and 3% of the proceeds goes to the county revenue fund, with 97% going to the state general fund.

Minnesota enacted a deed transfer tax in 1961 at a rate of $1.10 for consideration of $1,000 or less plus 55¢ for each $500 in excess of $1,000. In 1967 the rates were increased to $2.20 for consideration of $1,000 or less plus $1.10 for each $500 in excess of $1,000, and in 1987 the rate was increased to $1.65 for consideration of $500 or less plus $1.65 for each additional $500.

Tax Base

The tax base for the deed transfer tax is the granting, assigning, transferring, or otherwise conveying of real estate by deed, instrument, or writing. The most common situation is the transferring of real estate by deed.

Computation of the Tax

A tax of $1.65 is imposed in these situations:

1. transfers made by instruments pursuant to mergers, consolidations, sales, or transfers of substantially all of the assets of corporations pursuant to plans of reorganization; or
2. transfers made with no consideration; or
3. transfers made with consideration of $500 or less.

When the consideration is in excess of $500, the tax is $1.65 plus $1.65 for each $500, or fractional part of $500, in excess of $500.

The person who grants, assigns, transfers, or conveys real estate is liable for the tax. The deed, instrument, or writing cannot be recorded or registered unless the tax is paid or unless the transaction is exempt. The tax is paid to the county at the time of transfer.

EXEMPTIONS

10.01 DEEDS PARTITIONING PROPERTY OF CO-OWNERS

Minnesota Statutes, Section 287.22

Deeds to or from co-owners partitioning undivided interests in the same piece of property are exempt from the deed transfer tax.

This provision was enacted in 1984 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$100,000	$100,000

10.02 DEEDS OF DISTRIBUTION BY PERSONAL REPRESENTATIVES

Minnesota Statutes, Section 287.22

Deeds of distribution by personal representatives are exempt from the deed transfer tax.

This provision was enacted in 1975 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	*	*	*

10.03 DEEDS FOR CEMETERY LOTS

Minnesota Statutes, Section 287.22

Deeds or other instruments transferring cemetery lots are exempt from the deed transfer tax.

This provision was enacted in 1961.

Just under 30,000 cemetery lots are sold in Minnesota each year.

	Fiscal Year Impact		
	1993	1994	1995
Total - All Funds	$100,000	$100,000	$100,000

*Less than $50,000

CHAPTER 11: LAWFUL GAMBLING TAXES

Collections and History

In fiscal year 1992, revenues from the lawful gambling taxes were: $26.1 million from the tax on pull-tabs and tipboards; $2.3 million from the tax on bingo, raffles, and paddlewheels; and $25.8 million from the combined receipts tax. The proceeds from these taxes are deposited in the state general fund.

The lawful gambling tax was enacted in 1984 and covered bingo, raffles, paddlewheels, pull-tabs, and tipboards. Initially the tax was 10% of gross receipts less prizes for all types of lawful gambling.

A separate tax on pull-tabs was enacted 1986, and that tax was extended to tipboards in 1988. In 1989 the tax on pull-tabs and tipboards was changed from 10% of ideal net to 2% of ideal gross. The tax on pull-tabs and tipboards is imposed instead of, not in addition to, the 10% gambling tax. In 1989 an additional tax was imposed on the combined receipts of an organization from pull-tabs and tipboards.

Tax Base

The tax base is lawful gambling authorized by statute.

Computation of the Tax

The 10% lawful gambling tax covers bingo, raffles, and paddlewheels and is based on gross receipts less prizes actually paid out. Lawful gambling is allowed only by qualifying organizations which are licensed by the Gambling Control Board or which are exempt from licensing by statute. Organizations which are exempt from licensing are also exempt from the tax. The organization must be a fraternal, religious, veterans, or other nonprofit organization. The profits from the lawful gambling must be used only for the purposes specified by statute.

Pull-tabs and tipboards are subject to a separate tax which is 2% of the face resale value of all the pull-tabs or tipboards in each deal. A "deal" is defined as each separate package, or series of packages, consisting of one game of pull-tabs or tipboards. The tax is paid by the licensed distributors of pull-tabs and tipboards.

Organizations are subject to an additional tax on their gross receipts from pull-tabs and tipboards. The tax is imposed on the fiscal year combined receipts of the organization according to the following graduated rate schedule:

Fiscal Year Combined Receipts	Tax Rate
Not over $500,000	0 %
$500,001-$700,000	2 %
$700,001-$900,000	4 %
$900,001 and over	6 %

EXEMPTIONS

11.01 BINGO AT CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 349.166, Subd. 1(b)

An exemption from the lawful gambling tax is allowed for bingo conducted within a nursing home or a senior citizen housing project or by a senior citizen organization if the following conditions are met: the prizes for a single bingo game do not exceed $10; total prizes awarded at a single bingo occasion do not exceed $200; no more than two bingo occasions are held each week; and specified other conditions.

This provision was enacted in 1985 and was recodified in 1990.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

11.02 BINGO AT FAIRS AND CIVIC CELEBRATIONS

Minnesota Statutes, Section 349.166, Subd. 1(a)(1)

The 10% lawful gambling tax is not imposed on bingo conducted in connection with a county fair, the state fair, or a civic celebration if conducted twelve or fewer consecutive days in a calendar year.

This exemption was enacted in 1984 and was recodified in 1990.

About 130 organizations qualify for this exemption.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

11.03 INFREQUENT BINGO OCCASIONS

Minnesota Statutes, Section 349.166, Subd. 1(a)(2)

An exemption from the lawful gambling tax is allowed for bingo conducted by an organization which holds four or fewer bingo occasions in a calendar year. This exemption does not apply if the organization holds a lawful gambling license. For example, if an organization holds a license for pull-tabs, it cannot conduct bingo under this exemption.

*Less than $50,000

This exemption was enacted in 1984 and was recodified in 1990.

About 200 organizations qualify for this exemption.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

11.04 SMALLER RAFFLES

Minnesota Statutes, Section 349.166, Subd. 1(c)

If the value of all raffle prizes awarded by an organization in a calendar year does not exceed $750, then the raffles of that organization are exempt from the lawful gambling tax.

This provision was enacted in 1984 and was amended in 1986. It was recodified in 1990.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	*	*	*

11.05 RAFFLES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 349.166, Subd. 3

The lawful gambling tax does not apply to a raffle conducted by an organization that directly or under contract to the state or a political subdivision delivers health or social services and that is an organization exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The prizes awarded in the raffle must be real or personal property donated by an individual, firm, or other organization.

This exemption was enacted in 1984 and was recodified in 1990.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

*Less than $50,000

11.06 LAWFUL GAMBLING UNDER CERTAIN CONDITIONS

Minnesota Statutes, Section 349.166, Subd. 2

Lawful gambling is exempt from the lawful gambling tax if certain conditions are met, including that the organization conducts lawful gambling on five or fewer days in a calendar year and the organization does not award more than $50,000 in prizes for lawful gambling in a calendar year. The organization must follow specified procedures in order to qualify for the exemption.

This exemption was enacted in 1986 and was recodified in 1990.

About 1,200 organizations have been granted this exemption.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$700,000	$700,000	$700,000

CHAPTER 12: INSURANCE PREMIUMS TAXES

Collections and History

In fiscal year 1992, the revenues from the insurance premiums taxes totaled $124 million. The proceeds from these taxes are deposited in the state general fund.

A tax on insurance premiums was first enacted in Minnesota in 1868 at a rate of 2% of the premiums received by foreign (non-Minnesota) insurance companies. In 1872 the tax was extended to domestic (Minnesota) companies. The basic rate remains at 2%.

In 1913 the fire marshal tax was enacted at a rate of 0.375%, and the rate was increased to the current 0.5% rate in 1937. In 1934 a surcharge was enacted at a rate of 2% on fire, lightning, and sprinkler leakage premiums on property located in cities of the first class. The rate remains at 2% and the surcharge is in addition to other taxes. A tax on surplus lines insurance premiums was enacted in 1963 at a rate of 2%, and the rate was increased to the current 3% rate in 1978.

In 1953 the ocean marine profits tax was enacted at a rate of 5% on taxable underwriting profit from marine insurance written in Minnesota. This tax replaced the 2% gross premiums tax for this type of insurance. In 1992 the ocean marine profits tax was repealed, and ocean marine insurance is once again subject to the 2% gross premiums tax.

Tax Base

For purposes of this study, the tax base is defined as gross premiums less return premiums on all direct business received in Minnesota by domestic and foreign insurance companies.

Computation of the Tax

The 2% premiums tax is imposed on the gross premiums less return premiums received by domestic and foreign insurance companies on all direct business in Minnesota. A domestic company is one which is incorporated or organized in Minnesota and a foreign company is one which is incorporated in another state or country. A reduced rate of 0.5% applies to smaller mutual property and casualty insurance companies (Item 12.06).

The 0.5% fire marshal tax is imposed on the gross fire premiums and assessments less return premiums received by the company in Minnesota. Every insurance company must pay this tax, with the exception of farmers' and township mutual fire insurance companies (Item 12.04).

The 2% surcharge is imposed on the fire, lightning and sprinkler leakage gross premiums less return premiums on all direct business received by domestic and foreign fire insurance companies on property in cities of the first class. The cities of the first class are Minneapolis, St. Paul, and Duluth.

The 3% surplus lines insurance tax is imposed on total written premiums less cancellations for insurance placed with an insurer not licensed in Minnesota when coverage is not available from a Minnesota licensed insurer. The tax is paid by the Minnesota agent or broker who has a surplus lines license.

The amount of premiums tax paid, except for the surcharge, is allowed as a credit against the corporate franchise tax (Item 2.44) for those companies required to file corporate franchise tax returns.

EXEMPTIONS

12.01 FRATERNAL BENEFIT SOCIETIES

Minnesota Statutes, Section 64B.24

Fraternal benefit societies or associations are exempt from the Minnesota gross premiums tax. These societies are nonprofit, charitable organizations which provide life, sickness and/or accident benefits for their members.

This exemption dates back to 1907 and was last changed in 1985.

Forty-eight fraternal benefit societies did business in Minnesota in 1990.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$3,200,000	$3,400,000	$3,700,000

12.02 NONPROFIT HEALTH SERVICE PLAN CORPORATIONS

Minnesota Statutes, Section 62C.01, Subd. 3

Medical and hospital service associations organized and controlled by state law under the Minnesota Nonprofit Health Service Plan Corporations Act are exempted from the gross premiums tax.

This exemption was enacted in 1971 as part of the Minnesota Nonprofit Health Service Plan Corporations Act and has not been changed. Prior to the 1971 enactment, these entities were exempt under other statutory provisions.

Beginning January 1, 1996, a tax of 1% will be imposed on the premiums of nonprofit health service plan corporations. The proceeds from the tax will be deposited in the health care access fund.

Four nonprofit health service plan corporations do business in Minnesota.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$16,300,000	$18,600,000	$21,200,000

12.03 HEALTH MAINTENANCE ORGANIZATIONS

Minnesota Statutes, Section 62D.01, Subd. 2(b)

Health maintenance organizations qualifying under the Health Maintenance Act of 1973 are exempt from the Minnesota gross premiums tax.

This provision was enacted in 1973.

Beginning January 1, 1996, a tax of 1% will be imposed on the premiums of health maintenance organizations. The proceeds from the tax will be deposited in the health care access fund.

The premiums of eleven health maintenance organizations were exempted under this provision in 1991.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$29,300,000	$32,800,000	$36,800,000

12.04 FARMERS' MUTUAL AND TOWNSHIP MUTUAL FIRE INSURANCE COMPANIES (FIRE MARSHAL TAX)

Minnesota Statutes, Section 299F.21, Subd. 1

Farmers' mutual insurance companies and township mutual insurance companies are exempt from the fire marshal tax. All other insurance companies doing business in Minnesota are required to pay the tax which is 0.5% of gross fire insurance premiums and assessments received annually on all direct business in Minnesota.

This exemption was enacted in 1915 and was last changed in 1987.

Approximately 120 insurance companies receive this exemption.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$200,000	$200,000	$200,000

12.05 MINNESOTA COMPREHENSIVE HEALTH INSURANCE PLAN PREMIUMS

Minnesota Statutes, Section 62E.13, Subd. 10

The Minnesota Comprehensive Health Association (MCHA) was established by state law to provide health insurance coverage to high risk persons. Premiums received by the writing carrier for the MCHA plan are exempt from the 2% gross premiums tax.

This exemption was enacted in 1976 as part of the MCHA legislation. The exemption was repealed in 1987 but was re-enacted in 1988.

As of April 1992, there were more than 32,000 members of MCHA.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$900,000	$1,100,000	$1,400,000

REDUCED RATE

12.06 SMALLER MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANIES

Minnesota Statutes, Section 60A.15, Subd. 1(b)

The gross premiums tax rate imposed on certain mutual property and casualty insurance companies is 0.5% rather than the 2% rate imposed on insurance companies generally.

The reduced rate applies to mutual property and casualty insurance companies and to farmers' mutual and township mutual insurance companies. The reduced rate applies only to companies with total assets of $1.6 billion or less on December 31, 1989.

From 1905 to 1987, mutual property and casualty insurance companies paid the 2% gross premiums tax only on their fire, lightning, and sprinkler leakage premiums and were exempt from paying the tax on all other types of premiums. In 1987 the exemption was repealed so that they were subject to the 2% tax on all their premiums. In 1988 the rate of tax was reduced to 1.5% for 1988, 1% for 1989 through 1991 and 0.5% for 1992 and after.

In 1989 the lower rate was extended to companies writing principally workers' compensation. In 1990 the date for determining eligibility based on asset size was kept at December 31, 1989, instead of the end of the previous year.

The reduced rate applies to about 150 mutual insurance companies.

	Fiscal Year Impact		
	1993	1994	1995
State General Fund	$8,600,000	$8,900,000	$9,300,000

CHAPTER 13: PROPERTY TAX

Collections and History

Net property tax collections were $3.7 billion for property taxes payable in 1992. The property tax is collected by the counties and is distributed to the local units of government which impose the tax - counties, cities, townships, school districts, and special taxing districts. The state does not levy a general property tax. Although the property tax is entirely a local source of revenue, nearly all aspects of the tax are controlled by state statute.

The property tax was already in place when the first book of statutes was compiled for the Territory of Minnesota in 1851. Numerous changes have been made to the property tax since that time, a few of which are highlighted here.

The classification system was first enacted in 1913 with four classes of property. In 1933 the number of classes was expanded to provide preferential treatment for homestead property, both platted and unplatted.

Many important changes to the property tax system were enacted in 1967. The state property tax levy was eliminated, and a portion of the revenues from the newly-enacted sales tax was distributed to local units of government. The state-paid homestead credit, the rent credit, and the senior citizen credit also were enacted in 1967.

A number of changes in the taxation of the personal property of business began in 1967. In that year, livestock and agricultural machinery were exempted from the tax, and businesses were given the option to have either their inventories or their tools and machinery exempted. In 1971 the exemption for business property was expanded to include both inventories and tools and machinery. In 1973 an exemption also was enacted for commercial and industrial equipment attached to and considered as real property, known as attached machinery.

In 1971 levy limitations and local government aids were enacted which were important to determining the amount of the property tax levy. Modifications have been made to both of these programs since that time. The general levy limit for county and city governments has been removed beginning with taxes payable 1993. A "truth-in-taxation" system of reporting proposed levies to taxpayers and conducting levy hearings will be fully phased in for taxes payable 1993.

In 1988 several provisions were enacted that significantly altered a number of features of the system as it emerged after 1971. The concept of assessed value, calculated by multiplying classification percentages times estimated market value to obtain the taxable portion of value, was replaced by a tax capacity concept. Tax capacities are based on class rates applied to market values, and local tax rates now are expressed as percentages of total tax capacity in a taxing area, rather than as mill rates. Agricultural credit and state-paid homestead credit, long prominent features of Minnesota's property tax system, were replaced by homestead and agricultural credit aid in 1990. Disparity reduction aid began in 1989 and provides aid to high tax rate areas.

Tax Base

For purposes of this study, the tax base for the property tax is the market value of real and personal property in Minnesota. Generally, market value is the estimated selling price of the property. Other approaches to determining market value are considered to be substitutes for selling price and, therefore, are not tax expenditures.

Computation of the Tax

The computation of the property tax is different from the computation of other types of taxes in Minnesota. Unlike other tax types, the impact of a property tax expenditure affects the distribution of the tax rather than the total yield of the tax. For other taxes, the taxable amount (income, sales price, volume sold, etc.) is multiplied by a rate or set of rates specified by statute to yield the total tax. A preferential provision has an impact on the total yield of the tax. Any redistribution of that impact would require legislative action.

For the property tax, the taxable amount (tax capacity, which is market value times the class rate) is determined by statute. The total yield of the tax is not the result of computations by taxpayers but is determined by the unit of government which imposes the tax. The governing body of the local unit, such as the school board, the county board, or the city council, determines the amount of the levy and in so doing must take into account many factors, including the level of services provided, mandated programs, debt service, levy limitations, if any, and other sources of revenue such as local government aids. Since 1990, the county auditors also subtract the homestead and agricultural credit aid, disparity reduction aid, and equalization aid from the levies certified by taxing districts to determine the final levy.

The final levy is divided by the total taxable tax capacity of the taxing district to determine the local rate of tax. For each parcel, the tax capacity is multiplied by the aggregate local tax rate of the county, city or township, school district, and any special taxing districts to determine the gross tax. An exemption, class rate, or other preferential provision lowers the total tax capacity and results in a higher local tax rate applicable to all taxable property. Although the total yield from the tax is not affected, the tax is shifted from preferential to nonpreferential property.

Net tax is determined by subtracting from gross tax any applicable credits, including disaster credit, power line credit, agricultural preserves credit, enterprise zone credit, disparity reduction credit, guaranteed credit, taconite homestead credit, and supplemental homestead credit.

Additional tax relief is provided to qualifying homeowners and renters through the property tax refund. The property tax refund is based on the net homestead tax, or the tax attributable to the rental unit, and on household income, with the amount of refund phasing out as income increases. Another special refund is available to homeowners whose net property tax increases by more than a set percentage from the previous year. These refunds are paid directly to the claimants by the state.

The tax expenditure budget is a supplement to the regular state budget. Because the property tax refund, the special refund, and most of the property tax credits are included in the state budget as open and standing appropriations, they are not included in this report. The taconite homestead credit and the power line credit are not in the state budget and are therefore included in this report (Items 13.06 and 13.07).

EXEMPTIONS

13.01 EXEMPT PROPERTY

Minnesota Statutes, Sections 272.02, Subd. 1 and 273.18

Certain types of property are exempt from the property tax by statute, and they are included in the estimates below. Certain other types of property are exempt under either the Minnesota Constitution or federal law, and their exemption is not included in the tax expenditure estimates. These properties are churches, academies, colleges, universities, and Indian reservations.

Since 1926 the county assessors have been required to value exempt property every six years. The most recent valuation of exempt property took place in 1992. The estimates are based on the 1992 values with no growth assumed. The values were multiplied by a class rate of 4.7% for taxes payable in 1993 and 4.6% for 1994 and 1995. A statewide average tax capacity rate was computed or estimated for each year to arrive at the estimated net property tax figures shown below. In computing the estimates, the tax capacity rates were adjusted to take into account the additional taxable value which would result if the property were not exempt.

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 exempt property provisions were last changed in 1992.

	Net Property Tax - Fiscal Year Impact		
Type of Property	1993	1994	1995
Real Property:			
Elementary and secondary schools	$327,900,000	$326,700,000	$330,600,000
Public burying grounds	8,400,000	8,300,000	8,400,000
Hospitals	108,200,000	107,800,000	109,100,000
Charitable institutions	42,100,000	41,900,000	42,400,000
Federal and state forests, parks, and wildlife refuges	40,700,000	40,600,000	41,100,000
Public property used for public purposes	453,200,000	451,400,000	456,800,000
Total Real Property	$980,500,000	$976,700,000	$988,400,000
Total Personal Property*	$62,000,000	$62,000,000	$62,600,000
Total Exempt Property	$1,042,500,000	$1,038,700,000	$1,051,000,000

*Personal property includes iron ore stockpiles, direct products of furnaces, agricultural products, attached machinery, and commercial and industrial personal property.

PREFERENTIAL VALUATIONS

13.02 CLASSIFICATION SYSTEM

Minnesota Statutes, Section 273.13

Each parcel of taxable property is classified by type. The market value of the property is multiplied by the appropriate class rate(s), depending upon the type of property.

Due to the classification system, some types of property are treated preferentially compared to other types of property, the extent of the preferential treatment varying by property type. The classification system is considered a tax expenditure because each dollar of market value is not treated the same.

The estimates are summarized by the major types of property. The estimates assume that, instead of having many different class rates, all types of property are subject to the same rate.

The fiscal impacts reflect shifts in tax burdens. A positive figure indicates a tax increase that would result from uniform treatment and a negative figure a tax decrease.

The property tax classification system was enacted in 1913 and was last changed in 1992.

	Net Property Tax - Fiscal Year Impact		
Type of Property	1993	1994	1995
Farm	$127,500,000	$97,300,000	$97,300,000
Seasonal Recreational Residential	(14,400,000)	(15,300,000)	(15,300,000)
Seasonal Recreational Commercial	500,000	200,000	200,000
Residential	579,300,000	659,900,000	659,900,000
Apartments	(110,900,000)	(113,800,000)	(113,800,000)
Vacant Land	(40,600,000)	*	*
Commercial/Industrial	(548,700,000)	(600,700,000)	(600,700,000)
Public Utility	(57,700,000)	(61,200,000)	(61,200,000)
Mineral	(400,000)	(100,000)	(100,000)
Railroad	(8,400,000)	(9,800,000)	(9,800,000)
Personal	(73,300,000)	(79,000,000)	(79,000,000)

*Vacant land no longer a separate classification.

13.03 GREEN ACRES TREATMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 273.111

The Minnesota Agricultural Property Tax Law, referred to as "green acres", provides for preferential and deferred assessment of qualifying agricultural land consisting of ten or more acres. A qualifying parcel is valued according to its agricultural use. A higher value that would result from nonagricultural use is not used 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.

When green acres property no longer qualifies as such or is sold, a tax is due equal to the amount by which the preferential valuation has reduced the property tax for the previous three years.

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, at the non-metropolitan tax rate computed or estimated for each year.

This provision was enacted in 1967 and was last revised in 1991.

In 1992 approximately 1,250,000 acres received green acres treatment.

	Fiscal Year Impact		
	1993	1994	1995
Green Acres	$6,600,000	$7,600,000	$8,800,000

13.04 OPEN SPACE PROPERTY

Minnesota Statutes, Section 273.112

Private outdoor recreational, open space, and park land is given preferential valuation and tax deferment as long as it meets certain criteria. For property tax purposes, the property is valued at its current use rather than at a higher value that would reflect its potential use. For example, a golf course would be valued at its current use rather than at its potential use for commercial, industrial, or residential development.

When the open space property no longer qualifies for preferential valuation, taxes are due equal to the amount by which the preferential valuation reduced the tax for the previous seven years.

The Minnesota Open Space Property Tax Law was enacted in 1969 and was first effective for property taxes payable in 1971. It was last amended in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Open Space Property	$3,900,000	$4,500,000	$5,100,000

PREFERENTIAL COMPUTATIONS

13.05 AUXILIARY FOREST TAX AND TREE GROWTH TAX

Minnesota Statutes, Sections 88.47 to 88.53 and 270.31 to 270.39

Forest land is taxed under one of three taxes - the general property tax, the auxiliary forest tax, or the tree growth tax. The estimates reflect the amount by which the auxiliary forest tax or the tree growth tax is lower than the general property tax that would be paid for those properties. Both taxes are payable and distributed in the same manner as the general property tax.

Qualifying land was designated an auxiliary forest upon application by the owner and approval by the county board. The auxiliary forest tax applies for the duration of the contract. A 1974 law prohibited new auxiliary forest contracts from being issued or existing contracts from being extended after June 30, 1974. When a contract expires, the land automatically is enrolled in the tree growth tax program.

The auxiliary forest tax is 10¢ per acre of land plus a yield tax of from 40% to 10% of the value of the timber, the rate determined by the year of the harvest in relation to the contract period. To be classified as an auxiliary forest, the property must be either a minimum of 35 acres suitable for forestation or a wood lot of from five to forty acres.

To qualify for the tree growth tax, the property must be a minimum of five acres of forest lands used exclusively for the growing of continuous forest crops. The owner must apply to and receive approval from the county board to have qualifying property taxed under the tree growth tax.

The tax rates for the tree growth tax depend upon 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 5¢ per acre or 15¢ per acre for noncompliance with a reforestation agreement. Permanently nonproductive forest lands are taxed at 5¢ per acre.

The auxiliary forest tax was enacted in 1927. The tree growth tax was enacted in 1957.

Approximately 750,000 acres were taxed under these two programs in 1992.

	Fiscal Year Impact		
	1993	1994	1995
Auxiliary Forest Tax	$500,000	$500,000	$600,000
Tree Growth Tax	1,000,000	1,000,000	1,100,000
Total	$1,500,000	$1,500,000	$1,700,000

CREDITS

13.06 TACONITE HOMESTEAD CREDIT

Minnesota Statutes, Section 273.135

Homestead property within the defined taconite tax relief areas of Minnesota receives a credit against the property tax of either 57% or 66% of the net tax, the higher percentage applicable to property located in qualifying municipalities. The credit is limited to specified maximums and is calculated so that a homestead will not have a reduction in net tax of more than 5% from the previous year.

Taconite mining companies pay the taconite production tax in lieu of the property tax. Most of the proceeds from the production tax are distributed as aid payments to local governments in the taconite tax relief area because the land, buildings, and equipment used in connection with taconite mining, quarrying, or production are not subject to the property tax. The taconite homestead credit is funded from the taconite production tax to provide property tax relief to owner-occupied homes and farms in the taconite tax relief area.

The taconite homestead credit was enacted in 1969 and was last changed in 1989.

In 1992, 47,600 homesteads received this credit.

	Fiscal Year Impact		
	1993	1994	1995
Taconite Homestead Credit	$8,200,000	$7,800,000	$7,800,000

13.07 POWER LINE CREDIT

Minnesota Statutes, Sections 273.42, Subd. 2 and 273.425

The owner of qualifying 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 July 1, 1974. The credit is limited to 20% of the gross property tax for any forty acre parcel of property. The credit is financed by a portion of the property taxes paid by the transmission lines giving rise to the credit.

The power line credit was enacted in 1979 and was last changed in 1988.

About 1,750 parcels received this credit in 1992.

	Fiscal Year Impact		
	1993	1994	1995
Power Line Credit	$100,000	$100,000	$100,000

CHAPTER 14: AIRFLIGHT PROPERTY TAX

Collections and History

Revenues from the airflight property tax were $8 million in fiscal year 1992. The proceeds from this tax go to the state airports fund of the state treasury.

The airflight property tax was enacted in 1945. Originally the assessment ratio was 40%, but it was reduced to 33 1/3% in 1953. In 1987 the one assessment ratio was replaced by a schedule of ratios, and the use of the statewide average property tax mill rate was replaced by a revenue yield for each year specified by statute and the tax rate determined therefrom. In 1992 the calculation of the tax rate was changed to yield the difference between the total state airports fund appropriation and the fund revenues from other sources.

Tax Base

The tax base is the value of airflight property of airline companies engaged in air commerce.

Computation of the Tax

The property subject to the tax is the aircraft and flight equipment, including spare flight equipment, of airline companies. Airline companies are defined as those that engage in the business of air commerce, and air commerce is defined as the transportation by aircraft of persons or property for hire on flights by airline companies operating under authorization of the United States Department of Transportation.

Privately-used aircraft are subject to the aircraft registration tax (Chapter 16) in lieu of the airflight property tax. A privately-used aircraft that is used occasionally in transportation for hire is not subject to the airflight property tax if the person furnishing the transportation is not in the business of transportation for hire.

The value of the airflight property is determined by the Department of Revenue. The value is apportioned to Minnesota by a three-factor formula. The apportioned value is multiplied by a tax capacity ratio according to the following schedule:

40% for quiet aircraft (Item 14.02)
70% for other airflight property
50% of the above rates for the airflight property of certain airlines (Item 14.03)

The tax capacity is multiplied by a tax rate which is determined by dividing the revenue needed for the state airports fund by the total tax capacity. For taxes payable in 1992 the tax rate was 5.84%.

The tax is paid by the airline company to the Department of Revenue.

Under a provision in the Minnesota Constitution, the airflight property tax is in lieu of other property taxes on airflight property. Therefore, airflight property is exempt from the local property tax. However, the property tax does apply to the other property of an airline company.

PREFERENTIAL COMPUTATION

14.01 COMMUTER AIRLINES

Minnesota Statutes, Sections 270.072, Subd. 2 and 360.521

Generally, commercial aircraft are taxed under the airflight property tax, and noncommercial aircraft are taxed under the aircraft registration tax. However, commuter airlines have the option of having their aircraft taxed under one tax or the other, whichever is lower.

Because commuter airlines could be considered commercial, the exemption of commuter airlines from the airflight property tax because they pay the aircraft registration tax is considered a tax expenditure. The estimates reflect the difference between the aircraft registration tax paid by commuter airlines and the airflight property tax they would pay if subject to that tax.

This provision was enacted in 1969.

	Fiscal Year Impact		
	1993	1994	1995
State Airports Fund	*	*	*

PREFERENTIAL VALUATIONS

14.02 QUIET AIRCRAFT

Minnesota Statutes, Section 270.074, Subd. 3(a)

Airflight property is generally assessed at 70% of market value for the airflight property tax. However, quiet aircraft are assessed at 40% of market value. The tax expenditure is measured as the difference between the 40% and 70% tax capacity ratios.

Quiet aircraft include turboprops and aircraft defined as stage III by the Federal Aeronautics Administration. The classification may be extended to other types of qualifying aircraft through rules adopted by the commissioner of Revenue.

This provision was enacted in 1987 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
State Airports Fund	$1,100,000	$1,200,000	$1,300,000

*Less than $50,000

14.03 CERTAIN AIRLINES

Minnesota Statutes, Section 270.074, Subd. 3(b)

Quiet aircraft are assessed at 40% of market value and other airflight property is assessed at 70% of market value. If the airflight property is owned by qualifying airlines, the tax capacity ratio is 50% of the above rates (20% for quiet aircraft and 35% for other airflight property).

To qualify, the majority of the aircraft owned or leased by the airline company must be turboprops, and the airline company must provide scheduled passenger service to three or more airports that serve city or towns with a population of 100,000 or less outside the seven-county Minneapolis-St. Paul metropolitan area.

This provision was enacted in 1987 and has not been changed.

	Fiscal Year Impact		
	1993	1994	1995
State Airports Fund	$500,000	$500,000	$500,000

CHAPTER 15: MOTOR VEHICLE REGISTRATION TAX

Collections and History

In fiscal year 1992, a total of $350 million in motor vehicle registration tax was collected. All the proceeds from this tax are deposited in the highway user tax distribution fund.

A motor vehicle registration tax was first enacted in 1911 at a rate of $1.50 per vehicle. In 1921 a tax of 2% of value was enacted, with the minimum tax determined by the weight category of the passenger car or truck.

From 1921 to 1949 the tax was based primarily on value. In 1949 a tax based solely on weight was adopted, and for trucks the tax continues to be determined by weight. For passenger cars, however, a tax of $10 plus 1.25% of the base value was adopted in 1971 and remains in effect.

Tax Base

The tax base for the motor vehicle registration tax is motor vehicles that use the public streets and highways in Minnesota. The exemption of off-road vehicles, such as farm machinery, is therefore not considered to be a tax expenditure.

Historically, the tax has been based on weight, value, or a combination of the two, and currently the tax on passenger cars is based on value and the tax on trucks and buses is based on weight. Although arguments could be made for using either the weight system or the value system in the definition of the tax base, for purposes of this study one system is considered to be a replacement for the other. Therefore, neither the weight system nor the value system is considered to be a tax expenditure.

Computation of the Tax

The tax on passenger cars, pickup trucks, and vans is $10 plus 1.25% of the base value. Base value is the manufacturer's suggested retail price, including destination charges but excluding separately-stated options. The percentage of base value used to compute the tax decreases with the age of the vehicle, as follows: 100% in the first and second year of vehicle life; 90% in the third and fourth year; 75% in the fifth and sixth year; 60% in the seventh year; 40% in the eighth; 30% in the ninth; and 10% in the tenth year.

The flat tax for vehicles over ten years old and the minimum tax for all vehicles are both $35 ($10 plus $25 minimum additional tax).

The tax on trucks, tractors, and buses is based on the type, weight, and age of the vehicle. A minimum tax applies, the amount of which is determined by the type of vehicle.

The tax is paid when the vehicle is first registered and annually thereafter when it is reregistered.

EXEMPTIONS

15.01 LOCAL GOVERNMENT VEHICLES

Minnesota Statutes, Section 168.012, Subd. 1, 6, and 10

Vehicles owned or leased by a political subdivision of the state are exempt from the motor vehicle registration tax. Exempt vehicles include ambulances, fire equipment, utility fleets, police vehicles, and buses owned by city transit companies. Publicly owned or leased school buses are included in the estimate for Item 15.02.

The exemption for government vehicles was enacted in 1921 and was last changed in 1990.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$4,300,000	$4,400,000	$4,500,000

15.02 SCHOOL BUSES

Minnesota Statutes, Section 168.012, Subd. 1 and 10

Vehicles which are used by educational institutions for the sole purpose of transporting students to and from those institutions are exempt from the motor vehicle registration tax. Publicly owned or leased buses other than school buses are included in the exemption for government vehicles (Item 15.01).

This exemption was enacted in 1933 and was extended to leased vehicles in 1982.

Approximately 5,000 buses qualified for this exemption in 1991.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$300,000	$300,000	$300,000

15.03 NONRESIDENT MILITARY PERSONNEL

Minnesota Statutes, Section 168.04, Subd. 1

Vehicles of nonresident military personnel stationed in Minnesota are exempt from the motor vehicle registration tax if they meet the following four conditions: the vehicle is properly registered in another state; the owner is a resident of the state in which the vehicle is registered; the vehicle is used only for the owner's personal transportation; and 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 Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$200,000	$200,000	$200,000

15.04 MEDAL OF HONOR RECIPIENTS

Minnesota Statutes, Section 168.124

Congressional medal of honor recipients may obtain special license plates with 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.

Fewer than ten people have qualified for this exemption.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	*	*	*

15.05 DISABLED VETERANS

Minnesota Statutes, Section 168.031

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 1941 and was last changed in 1971.

Approximately 100 vehicles qualify for this exemption.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	*	*	*

*Less than $50,000

15.06 NONPROFIT CHARITIES

Minnesota Statutes, Section 168.012, Subd.1(a)(4)

An exemption from the motor vehicle registration tax is provided for vehicles owned by nonprofit charities and used exclusively to transport disabled persons for educational purposes.

This exemption was enacted in 1987.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	*	*	*

15.07 DRIVER EDUCATION PROGRAMS AT NONPUBLIC HIGH SCHOOLS

Minnesota Statutes, Section 168.012, Subd.1(a)(3)

Vehicles used solely in driver education programs at nonpublic high schools are exempt from the motor vehicle registration tax.

This provision was enacted in 1990.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	*	*	*

15.08 AMBULANCES OWNED BY PRIVATE AMBULANCE SERVICES

Minnesota Statutes, Section 168.012, Subd.1(a)(6)

Ambulances owned by private ambulance services licensed under Minnesota Statutes, Section 144.802 are exempt from the motor vehicle registration tax. To qualify, the appearance of the ambulance must be unmistakable.

This exemption was enacted in 1990. Ambulances owned by local units of government have been exempt since 1921 and are included in Item 15.01.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	*	*	*

*Less than $50,000

CREDIT

15.09 PHYSICALLY DISABLED PERSONS

Minnesota Statutes, Section 168.021

A motor vehicle or self-propelled recreational vehicle owned or primarily operated by a physically disabled person is eligible for special license plates bearing the international wheelchair symbol. The special license plates are also available to the custodial parent or guardian of a physically disabled minor and to an employer who owns a motor vehicle that is furnished to a disabled employee for that person's exclusive use in the course of employment. In each situation the disability must be permanent and a physician's statement must accompany the application.

The special license plates are subject to the full motor vehicle registration tax, but a one dollar credit is allowed for each month the vehicle is registered.

This provision was enacted in 1975. Eligibility was extended to parents and employers in 1989.

In 1991 just under 30,000 vehicles were allowed this credit.

	Fiscal Year Impact		
	1993	1994	1995
Highway User Tax Distribution Fund	$400,000	$400,000	$400,000

CHAPTER 16: AIRCRAFT REGISTRATION TAX

Collections and History

In fiscal year 1992, the revenues from the aircraft registration tax were $2.9 million. All the proceeds from this tax go into the state airports fund of the state treasury. Expenses incurred in administering the tax are reimbursed to the general fund each year.

The aircraft registration tax was enacted in 1945, and the basic structure and rate of the tax have remained the same since that time. In 1987 the minimum tax was increased from $10 to $50.

Tax Base

The tax base for the aircraft registration tax is the value of non-commercial aircraft which regularly use the airspace over and the airports in Minnesota. Technically, the base applies to aircraft operating without a certificate of convenience and necessity issued by the United States Department of Transportation.

Computation of the Tax

The aircraft registration tax is imposed upon aircraft which are used privately and which use the airspace over Minnesota or the airports in Minnesota.

The value used in the computation of the tax begins with the base price of the aircraft, which is the manufacturer's list price, or, if the list price is not available, the commissioner of Transportation's estimate of such. After the first year, the base price is reduced for depreciation - 10% in the second year and 15% for the third and each succeeding year, subject to the minimum tax.

The tax is 1% of the value. The minimum tax is the greater of: a) 25% of the tax computed on the original base price; or b) $50.

The tax is paid when the aircraft is first registered and annually thereafter.

EXEMPTIONS

16.01 LOCAL GOVERNMENT AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 2

Aircraft owned and used solely in the transaction of official business by local govenment units are exempt from the aircraft registration tax.

This provision was enacted in 1945 and was last amended in 1965.

	Fiscal Year Impact		
	1993	1994	1995
State Airports Fund	*	*	*

16.02 CIVIL AIR PATROL AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 3

Aircraft owned and used solely in the transaction of offical business by the Civil Air Patrol are exempt from the aircraft registration tax.

This exemption was enacted in 1957 and remains unchanged.

	Fiscal Year Impact		
	1993	1994	1995
State Airports Fund	*	*	*

*Less than $50,000

APPENDIX A: MINNESOTA STATUTE REQUIRING THE TAX EXPENDITURE BUDGET

270.067 TAX EXPENDITURE BUDGET.

Subdivision 1. **Statement of purpose.** State governmental policy objectives are sought to be achieved both by direct expenditure of governmental funds and by the granting of special and selective tax relief or tax expenditures. Both direct expenditures of governmental funds and tax expenditures have an effect on the ability of the state and local governments to lower tax rates or to increase expenditures. As a result, tax expenditures should receive a regular and comprehensive review by the legislature as to (a) their total cost, (b) their effectiveness in achieving their objectives, (c) their effect on the fairness and equity of the distribution of the tax burden, and (d) the public and private cost of administering tax expenditure financed programs. This section is intended to facilitate a regular review of the state and local tax expenditure budget by the legislature by providing for the preparation of a regular biennial tax expenditure budget.

Subd. 2. **Preparation; submission.** The commissioner of revenue shall prepare a tax expenditure budget for the state. The tax expenditure budget report shall be submitted to the legislature as a supplement to the governor's budget and at the same time as provided for submission of the budget pursuant to section 16A.11, subdivision 1.

Subd. 3. **Period covered.** The report shall include estimates of annual tax expenditures for, at a minimum, a three-year period including the two-year period covered in the governor's budget submitted in the preceding January pursuant to section 16A.11.

Subd. 4. **Contents.** 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. The report may contain additional information which the commissioner considers relevant to the legislature's consideration and review of individual tax expenditure items. This may include, but is not limited to, statements of the intended purpose of the tax expenditure, analysis of whether the expenditure is achieving that objective, and the effect of the expenditure device on the distribution of the tax burden and administration of the tax system.

Subd. 5. **Revenue estimates; legislative bills.** Upon reasonable notice from the chair of the house or senate tax committee that a bill is scheduled for hearing, the commissioner of revenue shall prepare an estimate of the effect on the state's tax revenues which would result from the passage of a legislative bill establishing, extending, or restricting a tax expenditure. These revenue estimates shall contain the same information as provided in subdivision 4 for expenditure items contained in the tax expenditure budget, as appropriate.

Subd. 6. **Definitions.** For purposes of this section, the following terms have the meanings given:

(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 special law or to a special local tax levied pursuant to general authority that is no longer applicable to local governments generally.

History: 1983 c 301 s 176; 1986 c 444; 1Sp1989 c 1 art 17 s 1,2; 1991 c 291 art 21 s 8,9

APPENDIX B: INACTIVE TAXES

Agglomerating Facilities Production Tax. Minnesota Statutes, Section 298.393

Iron Bearing Materials Other Than Taconite and Semi-Taconite Production Tax. Minnesota Statutes, Section 298.405

Net Proceeds Tax. Minnesota Statutes, Section 298.015

Semi-Taconite Production Tax. Minnesota Statutes, Section 298.35

Taconite Tailing Tax. Minnesota Statutes, Section 298.24, Subd. 2

APPENDIX C: TAXES WHICH CONTAIN NO TAX EXPENDITURE PROVISIONS

Aviation Fuels Excise Taxes. Minnesota Statutes, Section 296.02 and 296.025

Controlled Substances Tax. Minnesota Statutes, Section 297D.08

Hazardous Waste Generator Tax. Minnesota Statutes, Section 115B.22

Marine Gasoline Excise Tax. Minnesota Statutes, Section 296.02

Pari-Mutuel Betting Tax. Minnesota Statutes, Section 240.15

Rural Electric Cooperative Membership Tax. Minnesota Statutes, Section 273.41

Severed Mineral Interests Tax. Minnesota Statutes, Section 273.165

Taconite Production Tax. Minnesota Statutes, Section 298.24

Trust Companies Gross Earnings Tax. Minnesota Statutes, Section 295.37

Unmined Taconite Tax. Minnesota Statutes, Section 298.26

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