Governor's FY 2010-11 Unallotment

and Other Administrative Actions

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A deficit of $2.676 billion remained for the fiscal years 2010-11 biennium after the Governor vetoed various provisions passed by the 2009 Legislature. Rather than calling a special session of the Legislature to attempt to resolve that deficit the Governor decided to resolve the deficit using the unallotment authority in law (Minnesota Statutes 16A.152, Subdivision 4) and making some other administrative changes.

Fiscal Analysis Department
Minnesota House of Representatives

Unallotments and Other Administrative Actions

On June 16, 2009, Minnesota Management and Budget Department Commissioner Tom Hanson sent to the Governor a letter outlining proposed spending reductions, payment delays and deferrals, and administrative actions to offset the projected $2.676 billion deficit for the fiscal years (FY) 2010-11 biennium.

The commissioner called two meetings of the Legislative Advisory Commission (LAC) on June 18 and June 30 for consultation on the budget actions as required by law. At the June 29 LAC meeting the Commission adopted a resolution stating the proposed "allotment reductions and administrative actions" would "be unwise and no in the interest of the state's long-term fiscal stability". LAC action is advisory only.

The actions taken by the Governor and Commissioner of Minnesota Management and Budget to balance the FY 2010-11 general fund budget fit into several categories. The law authorizing unallotment of appropriations also authorizes deferral or suspension of obligations so as to prevent reductions. Many of the items listed on Table 1 are reductions in payments but the single largest item, the education aid payment deferral of $1.17 billion, is a change in the payment schedule of aid payments to school districts that is effective for fiscal years 2010 and 2011 only. That requires the $1.17 billion of deferred payments to be repaid in FY 2012.

In addition to the education aid payment change, several other payment deferrals operate in a similar manner. As a result the projected general fund budget deficit for FY 2012-13 is increased by $1.326 billion from $3.105 billion to $4.431 billion.

The initial list of budget actions was modified in a June 25 memo from Commissioner Hanson and again on June 29. The list of unallotments was finalized July 1 and is shown in Table 1 on the next page.

Table 1

Governor's Unallotment - Including Revisions

Governor's proposals for FY 2010-11 and impact in FY 2012-13

Dollars in thousands

	FY 2010	FY 2011	FY 2010-11	FY 2012	FY 2013	FY 2012-13
Property Tax Revenue Recognition Adjustment		-600,672	-600,672			
Education Aid Payment Deferral	-1,068,593	-101,767	-1,170,360	1,170,360		1,170,360
E-12 Education Total	-1,068,593	-702,439	-1,771,032	1,170,360	0	1,170,360
MNSCU	0	-50,000	-50,000			0
University of Minnesota	0	-50,000	-50,000			0
Higher Education Total	0	-100,000	-100,000	0	0	0
Delay Capital Equipment Refunds	0	-63,000	-63,000	63,100		63,100
Delay Corporate Franchise Tax Refunds		-42,000	-42,000	42,040		42,040
No Political Contribution Refund	-4,300	-6,100	-10,400			0
Cap Sustainable Forest Investment Payments	0	-5,500	-5,500			0
Adjust Renter's Refund 19% to 15%	0	-50,800	-50,800			
Local Government Aid (City)	-44,620	-102,384	-147,004			
County Program Aid	-33,000	-67,000	-100,000			
Market Value Credit	-22,067	-30,916	-52,983			
Income Tax/Prop Tax Interactions		2,939	2,939	6,104	1,000	7,104
LGA/Property Tax Refund Interactions	0	2,757	2,757	5,707	878	6,585
Tax Aids & Credits Total	-103,987	-362,004	-465,991	116,951	1,878	118,829
Suspend ICF/MR Occupancy Rate Adjustment	-225	-225	-450			
Reduce County Mental Health Grants	-5,000	-3,770	-8,770			
Eliminate Three Chemical Dependency Grants	-393	-393	-786			
Cap Chemical Dependency Payment Rates	-3,622	-3,622	-7,244			
Restructure State Operated Services - Spending Reduction	-422	-4,588	-5,010			
Restructure State Operated Services - Revenue Increase	-3,550	-5,870	-9,420	-5,870	-5,870	-11,740
Eliminate Child Support Enforcement County Grants	-3,400	-3,400	-6,800			
Eliminate Carry-Forward of Am Indian Child Welfare Grant	-600	0	-600			
Reduce Children & Community Service Grants	-16,900	-22,500	-39,400			
Eliminate Emergency GA/MSA	-6,000	-9,000	-15,000			
Eliminate Special Diet Funding - MSA Grants	-2,133	-3,200	-5,333			
Reduce GRH Supplementary Service Rate 5%	-467	-706	-1,173			
Eliminate Redesign Council Funding	-350	0	-350			
Suspend Construction Projects, Reduce County Ser Grant	-3,600	-3,600	-7,200			
Delay Continuing Care Grants Payments	0	-2,500	-2,500	2,500		2,500
Limit ICF/MR Variable Rates	-182	-700	-882			
Reduce PCA Worker Hours to 275 per Month	-825	-1,326	-2,151			
Suspend Nursing Facility Rebasing	-3,420	-2,520	-5,940			
Non-Primary Care Fee for Service Rates Reduced 1.5%	-2,100	-2,775	-4,875			
Specialist Fee for Service Rates Reduced 1.5%	-1,905	-2,445	-4,350			
MA Critical Access Dental Payments Eliminated	0	-6,200	-6,200			
Outreach Incentive Program GF Suspended	-1,196	-6,374	-7,570			
Aligning Asset Limits	0	-6,100	-6,100			
End GAMC Effective March 1, 2010	-15,000	0	-15,000			
Managed Care Withhold Increased to 9.5%	-3,788	-8,413	-12,201	7,298	5,953	13,251
Suspend Growth Factor in DD Waiver Allocations	-1,493	-4,481	-5,974			
Inpatient Hospital Payment Delay (additional)	0	-5,500	-5,500	5,500		5,500
Non-Inpatient Acute Payment Delay (additional)	0	-23,400	-23,400	23,400		23,400
Health & Human Services Total	-76,571	-133,608	-210,179	32,828	83	32,911
Agency Operating Reductions (2.25%)	-9,762	-13,629	-23,391	3,870		3,870
Agency-Wide Total	-9,762	-13,629	-23,391	3,870		3,870
Total Unallotment	-1,258,912	-1,311,680	-2,570,592	1,324,009	1,961	1,325,970
Modify WI/MN Income Tax Reciprocity Agreement	-35,000	-70,700	-105,700			0
Other Total	-35,000	-70,700	-105,700			0
Totals	-1,293,912	-1,382,380	-2,676,292	1,324,009	1,961	1,325,970

The Table 1 information included $11.689 million in reductions each year attributed to agency operations. Agencies had until July 28, 2009 to finalize the FY 2010 reductions and August 14, 2009 to finalize the FY 2011 reductions. To the extent details have been provided on those reductions they are shown in Table 2.

Two of the reductions in spending result in related costs to the state and those costs are also must be covered in the unallotment calculation. Reductions in aid to local governments are assumed to result in increased property tax levies by those local governments. This increase will cause a small decrease in income tax revenue as more property tax payments are deducted from income taxes. The increase in property taxes will also result in increased property tax refunds. Both of these items are discussed further in the tax section.

Reductions in spending within the Department of Human Services will result in the loss of federal matching funds for the reduced spending that was eligible for the matching funds. The cost is shown in the Department of Human Services section of Table 2.

Following Table 2 is more detailed discussion of the unallotments and administrative changes as they affect K-12 Education, Health and Human Services, and Taxes.

Table 2
Detail on the Agency Operating Budget Reductions
Dollars in thousands
A negative number is general fund savings, a positive number is a cost

	FY 2010	FY 2011	Total
Administration Department			
Government & Citizen Services	-100.0	-200.0	-300.0
Office Supply Connection	-162.0	-	-162.0
Total Administration	**-262.0**	**-200.0**	**-462.0**
Agriculture Department			
Pesticide & Fertilizer Management	-27.0	-27.0	-54.0
Plant Protection	-63.0	-63.0	-126.0
Dairy & Food Inspection	-133.0	-133.0	-266.0
Livestock Premise	-5.0	-5.0	-10.0
Ag Marketing Services	-50.0	-50.0	-100.0
Integrated Pest Management	-77.0	-77.0	-154.0
Dairy Development Program	-69.0	-69.0	-138.0
Agency Services	-68.0	-68.0	-136.0
Feeding MN Task Force	-1.0	-	-1.0
Total Agriculture	**-493.0**	**-492.0**	**-985.0**
Commerce Department			
Administrative Services	-97.0	-97.0	-194.0
Market Assurance	-150.0	-150.0	-300.0
Total Commerce	**-247.0**	**-247.0**	**-494.0**
Education Department			
Agency Operations	-389.5	-431.5	-821.0

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Dollars in thousands
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	FY 2010	FY 2011	Total
School Administrators Board	-3.9	-3.9	-7.8
Teaching Board	-14.0	-14.0	-28.0
Early Hearing Loss Intervention	-30.0	-40.0	-70.0
Kindergarten Entrance Assessment	-6.5	-6.5	-13.0
Educate Parents Partnership	-1.1	-1.1	-2.2
Total Education	**-445.0**	**-497.0**	**-942.0**
Employment & Economic Development Dept.			
Business & Community Development	-62.0	-62.0	-124.0
Office of Science & Technology	-25.0	-25.0	-50.0
Job Skills Partnership Program	-15.0	-15.0	-30.0
MI-Support Employment	-11.0	-11.0	-22.0
Services for the Blind	-89.0	-89.0	-178.0
Administration	-83.0	-83.0	-166.0
Total Employment & Economic Dev	**-285.0**	**-285.0**	**-570.0**
Governor's Office			
Office Operations	-67.8	-67.8	-135.6
Necessary Expenses	-13.0	-13.0	-26.0
Total Governor's Office	**-80.8**	**-80.8**	**-161.6**
Health Department			
Community & Family Health Promotion	-53.0	-355.0	-408.0
Policy Quality & Compliance	-118.0	-74.0	-192.0
Health Protection	-150.0	-74.0	-224.0
Administrative Support Services	-131.0	-22.0	-153.0
Pentachlorophenol	-55.0		-55.0
PFC Citizens Advisory Group	-20.0	-	-20.0
Total Health Department	**-527.0**	**-525.0**	**-1,052.0**
Historical Society			
Education & Outreach	-95.8	-95.8	-191.5
Preservation & Access	-72.0	-72.0	-144.0
Total Historical Society	**-167.8**	**-167.8**	**-335.5**
Housing Finance Agency			
FY 2011 Appropriation		-256.0	-256.0
Rehabilitation Loan Program	-256.0	-	-256.0
Total Housing Finance Agency	**-256.0**	**-256.0**	**-512.0**
Human Rights Department			
Human Rights Enforcement	-79.3	-79.3	-158.6
Total Human Rights Department	**-79.3**	**-79.3**	**-158.6**
Human Services Department			

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	FY 2010	FY 2011	Total
Health Care Administration	-180.0		-180.0
Administrative Operations	-3,109.0	-3,282.0	-6,391.0
Federal Funds Loss	1,315.6	1,312.8	2,628.4
Total Human Rights Department	**-1,973.4**	**-1,969.2**	**-3,942.6**
Labor & Industry Department			
Labor Standards Division	-19.8	-19.8	-39.6
Total Labor & Industry Department	**-19.8**	**-19.8**	**-39.6**
Mediation Services Bureau			
Mediation Services	-16.0	-16.0	-32.0
Total Mediation Services Bureau	**-16.0**	**-16.0**	**-32.0**
Metropolitan Council			
Metro Rail Operations	-119.0	-119.0	-238.0
Metro Transit Assistance	-1,506.0	-1,506.0	-3,012.0
Metro Parks	-86.0	-86.0	-172.0
Total Metropolitan Council	**-1,711.0**	**-1,711.0**	**-3,422.0**
Minnesota Management & Budget Department			
Agency Operations	-459.0	-459.0	-918.0
Total MN Management & Budget Dept.	**-459.0**	**-459.0**	**-918.0**
Natural Resources Department			
Lands & Minerals Management	-30.0	-30.0	-60.0
Waters Resources Management	-84.0	-84.0	-168.0
Forest Management	-135.0	-135.0	-270.0
MN Forest Resources Council	-53.0	-53.0	-106.0
Parks & Recreation Management	-379.8	-381.5	-761.3
Wild & Scenic Rivers	-40.0	-40.0	-80.0
Enforcement	-230.0	-230.0	-460.0
Operations support	-112.5	-112.5	-225.0
Prairie Wetlands	-265.0	-265.0	-530.0
Ecological Resources	-46.5	-46.5	-93.0
Stream Protection	-99.2	-97.5	-196.7
Total Natural Resources Department	**-1,475.0**	**-1,475.0**	**-2,950.0**
Enterprise Technology Office			
Office	-33.6	-33.6	-67.3
Enterprise IT Security	-95.9	-95.9	-191.8
Total Enterprise Technology Office	**-129.6**	**-129.6**	**-259.1**
Higher Education Office			
Administration	-77.0	-77.0	-154.0

Table 2
Detail on the Agency Operating Budget Reductions
Dollars in thousands
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	FY 2010	FY 2011	Total
Total Higher Education Office	**-77.0**	**-77.0**	**-154.0**
Pollution Control Agency			
Administrative Support	-12.0	-14.7	-26.7
Multimedia Program Operations		-16.2	-16.2
Environmental Health & Biomonitoring		-30.0	-30.0
Water Program Operations		-38.0	-38.0
Stormwater Management	-98.0		-98.0
Total Pollution Control Agency	**-110.0**	**-99.0**	**-209.0**
Revenue Department			
Tax System Management	-924.5	-949.9	-1,874.4
Special Timing Account Appropriation		-3,870.1	-3,870.1
Total Revenue Department	**-924.5**	**-4,820.0**	**-5,744.5**
Transportation Department			
Transit Improvement Administration	-9.0	-9.0	-18.0
Rail Service Plan	-9.0	-9.0	-18.0
Roosevelt Tower	-5.6	-5.6	-11.1
Total Transportation Department	**-23.6**	**-23.6**	**-47.1**
Total All Agencies:	**-9,761.6**	**-13,628.9**	**-23,390.5**

If you have further questions about the overall unallotment, please contact Bill Marx at 651-296-7176 or bill.marx@house.mn

K-12 Education Unallotment

For FY 2010 and FY 2011, the Governor has "unallotted" a portion of school funding using the authority in M.S. 16A.165. The reductions come in two areas: reductions related to the school aid payment percentage and reductions related to the property tax payment recognition by school districts.

School Aid Payment Percentage

The state aid share of school district revenue allocated through each education finance formula is called the "aid entitlement." The amount paid to school districts by the State during each fiscal year is called the "appropriation." Most of the funding for public schools is paid during the fiscal year in which the aid entitlement exists (the "current year"), with the balance paid in final payments the next fiscal year. The timing of the percentage of the entitlement paid in each fiscal year is set in State statute (M.S. 127A.45). Under current law, for FY 2010 and FY 2011 the payment percentage is 90 percent of the entitlement appropriated in the current fiscal year, and 10 percent in the subsequent fiscal year.

The Governor's unallotment reduces FY 2010 appropriations by $1.1 billion and FY 2011 appropriations by $101.7 million. This reduction mimics the savings that would be achieved by changing the payment schedule from 90 percent current year plus 10 percent final year to 73 percent current year plus 27 percent final year. The reductions are made to each appropriation that is paid using the payment percentage. However, unlike a statutory aid payment change, this change can only be made on a one-time basis using the unallotment delay process, for FY 2010 and FY 2011. The payment schedule is assumed to revert to 90/10 in FY 2012.

Property Tax Revenue Recognition

In addition, for FY 2011, the general education appropriation is reduced by $600.7 million as part of unallotment process connected to when school districts will be required to recognize revenue received from property tax payments. Currently, districts collect property tax payments in May and October of each calendar year, with the payments allocated as revenue for the school year beginning in July of that calendar year. As part of the unallotment process the Governor is requiring school districts to recognize the May payment as revenue for the fiscal year ending in June of the calendar year, which generates State general fund savings of $600.7 million. The Governor argues that this "shift" of property tax revenue from one fiscal year to the prior fiscal year is permanent because of the provision in M.S. 123B.75, subdivision 5, which allows the commissioner of education to specify for which fiscal year certain property tax revenues are to be recognized as revenue, and is, therefore, not subject to revocation in future bienniums based on the conditions of unallotment.

For more information on K-12 Education issues, contact Greg Crowe at 651-296-7165 or greg.crowe@house.mn.

Human Services Unallotment

One of the largest targets for the Governor's unallotment savings is the Department of Human Services. Total reductions for the department equal just over $200 million for the 2010-11 biennium from gubernatorial action, but also would result in a loss of federal match of an additional $72 million. Roughly twenty separate proposals make up the $200 million savings and they range from administrative reductions to programmatic changes.

Most of the programmatic changes include the suspensions of projects, grants or inflationary increase as well as temporary ratable (provider rate) reductions. In the case of ratable reductions, many are in addition to ratable reductions made by the legislature in the 2009 session.

The largest number of changes come from the Governor's action to eliminate or suspend funding for programs during the two years of the biennium. In most cases, ongoing programmatic funding is not permanently removed and would return to normal in the 2012-13 biennium. Items of a one-time only nature that were unalloted will not go forward unless re-authorized by a future legislature.

Suspension of Inflationary Mechanisms

The Governor suspends four inflationary mechanisms for two years to save a total of $13.2 million dollars. The governor suspends nursing facility rebasing beginning in 2010. This move would save nearly $6 million in inflationary increases to nursing facilities moving forward the suspension the legislature imposed on the same facilities for 2012-13. Nursing facilities would not receive the automatic inflationary increases until fiscal 2014 under the new arrangement.

Also suspended are variable rate adjustments to ICF/MR's (Intermediate Care Facilities for Mentally Retarded and related conditions) saving $900,000, and suspending ICF/MR occupancy rate adjustments saving $450,000. Finally, the Governor suspends disability waiver growth by removing additional 1 percent growth in waiver slots saving nearly $6 million.

Suspension of Program Funding

The Governor eliminates funding for fiscal years 2010-11 for grants to counties to pay administrative costs for child support enforcement, saving the state $7.2 million.

Also eliminated are Emergency GA and MSA (General Assistance/Minnesota Supplemental Assistance), which are programs that give people small cash amounts in times of need to make rent, security deposits, or pay a bill. The grants are small (usually less than $90) and not ongoing monthly payments. The elimination of these programs saves $15 million.

Funding to pay for medically prescribed special diets has been eliminated saving $5.3 million. The funding paid for special prescribed diets only for persons on the MSA (Minnesota Supplemental Aid) program.

Governor Pawlenty suspends funding for Critical Access Dental payments saving $6.2 million beginning in the in the third quarter of fiscal 2011.

Also suspended are general fund dollars for the health outreach incentives programs. The funding is used by community action agencies to do outreach work and assist members of the public with applying for public health care programs. Funding for this purpose from the health care access fund is left intact.

In addition to the Governor's veto of all funding for General Assistance Medical Care for all of fiscal 2011, the Governor unalloted an additional $15 million in fiscal 2010 which will shut down the program a month earlier.

New construction funding grants for Red Lake are suspended for the biennium saving $7.2 million.

Two one-time items were eliminated, saving $950,000. The Governor eliminated the carry forward authority of the White Earth tribe to use dollars that went previously unspent in the 2008-09 biennium. The tribe was granted carry forward authority to keep $800,000 of unspent child welfare funds by the legislature, and the governor's action will allow them to keep only $200,000 of the unspent funds. Also eliminated was $350,000 of one time funds for a task force that would redesign funding mechanisms for county human service programs.

Shifts and Payment Delays

Several "shifts" or payment delays were also part of the Governor's plan to unallot. These policy changes do not include cuts, but delay payments and push costs to the future biennium.

All continuing care grant payments are delayed one month, which would shift $2.5 million into the next biennium. Inpatient hospital payments and non-inpatient acute care payments would also be delayed one month. The savings realized by the two payment delays would total just short of $29 million in FY 2011.

The Governor also increased the managed care withhold by an additional 1.5 percent effective in FY 2010. The legislature had passed a withhold of this magnitude but phased the payment delay in three stages. The change by the governor makes the full withhold take effect at once to begin savings to the state sooner. This change saves an additional $12.2 million in the 2010-11 biennium.

Rate and Grant Reductions

Rates for Specialists and Non-Primary Care physician services will be reduced an additional 1.5 percent over the reductions made by the legislature. These cuts to MA and GAMC programs will save an estimated $9.1 million. Other rate reductions include a 5 percent reduction on group residential housing supplementary service rate will save $1.1 million. A temporary rate reduction by placing a cap on chemical dependency rates will save $7.2 million.

The Governor also reduces County Mental Health Grants be reduced by $8.7 million due to temporary increase in available federal funding from the American Reinvestment and Recovery Act.

The largest single reduction in the Human Services area comes from Governor Pawlenty's reductions of Children and Community Services Grants. These block grants are primarily used by the counties to fund programs for children and adolescents. The statewide reduction totals $39.4 million over the biennium by reducing the block grants by 25 percent in fiscal 2010 and 33 percent for fiscal 2011.

Programmatic Policy Changes

Other programmatic changes include a further reduction in allowable hours a person may receive from a personal care attendant in a given month. The legislature transformed the program from an uncapped program to instituting a cap of 310 hours. The Governor further reduces this cap to 275 hours. The effect essentially reduces service from an average of 10 hours per day for every day in a month to slightly over nine hours per day average and saves $2.1 million.

The last change temporarily aligns the asset limits for parents on MA and the Elderly and Disabled. Since the proposal will have an impact on enrollment, it will only be in effect for the second half of fiscal 2011, and not affect the state's ability to receive additional Medicaid funding under the federal stimulus act. The reductions will require a further spend down of assets before admission to the program from $10,000 to $3,000 for a single person, and from $20,000 to $6000 for a family of two or more. This six month change is projected to save $6.1 million.

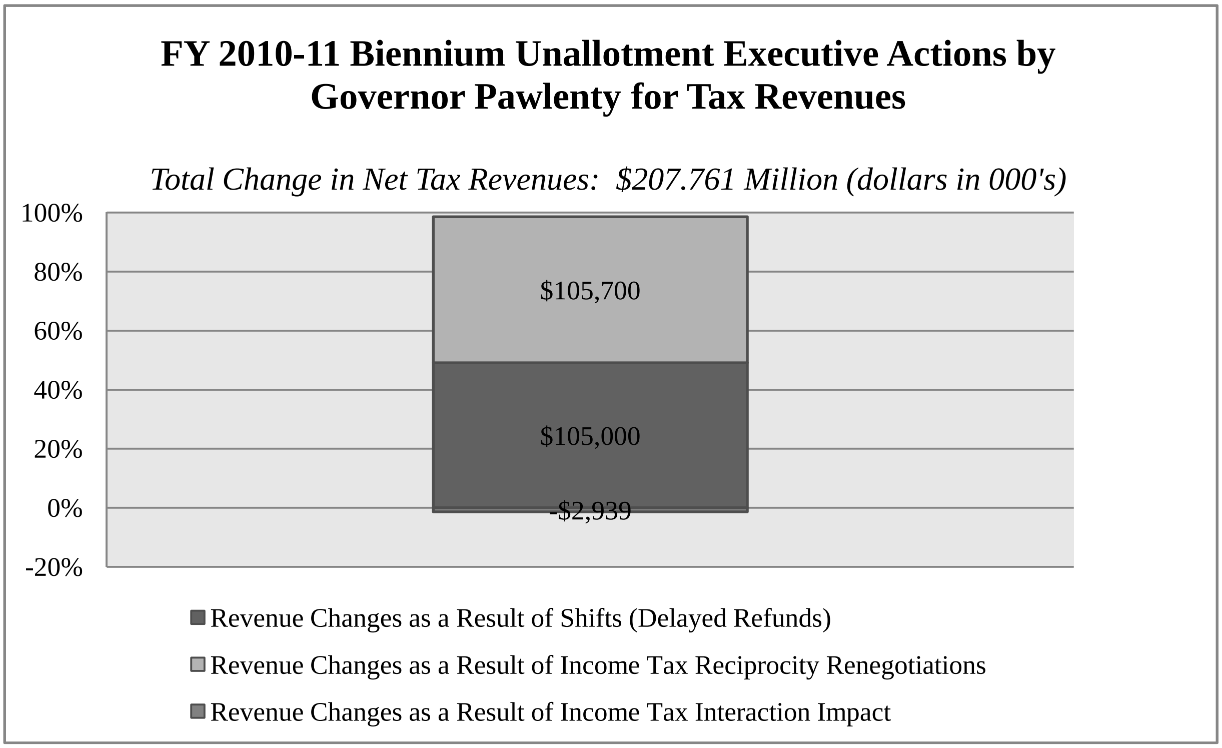
If you have further questions about Health and Human Services issues, please contact John Walz at 651-296-8236 or john.walz@house.mn

Tax Revenues Administration Actions

In addition to the unallotment reductions, Governor Pawlenty also announced two administrative actions that are expected to generate a net gain of $207.7 million in tax revenues in the FY 2010-11 biennium. Of the $207.7 million net gain, $105.7 million or 50 percent of the anticipated revenue gain comes from the proposal to renegotiate and accelerate the income tax reciprocity payments received from the State of Wisconsin. About 49 percent or $105.0 million of the estimated revenue gain is generated from the delay of refund payment shifts for corporate franchise tax and sales (capital equipment) tax. The total revenue gain in the FY 2010-11 biennium, however, is offset by a $2.9 million revenue reduction from income tax and corporate franchise tax interaction impacts resulting from unallotment reductions to local government aids and credit programs. In total, these administrative actions are estimated to generate a *one-time only* increase of less than one percentage point (0.69 percent) to the general fund tax and non tax revenue base in the FY 2010-11 biennium.[1] Chart 1 provides more detail about the estimated tax revenue gain in the FY 2010-11 biennium by source from these administrative actions.

[1] The general fund tax and non tax revenue base is $29,904,777 based on the 2009 February Forecast. The general fund tax revenue base is $28,474,593 and the non tax general fund base is $1,430,184. For more detail, see the February Forecast 2009 General Fund Balance (March 3, 2009).

Chart 1.



Impact of Reciprocity on State Income Tax Revenues

	FY 2010-11 Biennium	FY 2012-13 Biennium
Revenue Impact	$105.700 million	--

The proposal by Governor Pawlenty is to permanently modify this reimbursement schedule so that the State of Minnesota would be reimbursed for losses that occur in CY 2010. Under this proposal, Minnesota would receive half of the CY 2010 reimbursement in FY 2010 (by the end of June 2010) and half in FY 2011. Future reimbursements would follow the same schedule.

This proposal would provide a one-time shift forward of $105.7 million in additional revenue into the FY 2010-11 biennium. To accelerate this payment per Minnesota's request, Wisconsin would need to appropriate $35 million in FY 2010 and $70.7 million in FY 2012. There would be no additional revenue gain (or cost) in the FY 2012-13 biennium. Interest could be still be paid on any settle-up payments.

The proposal to modify (or accelerate) the timing of the reimbursement would have no impact to taxpayers, to state agencies or employers. Changing the timing of the reimbursement would not change the following:

- Taxpayer income tax liability (burden);

- Taxpayer convenience (because taxpayers would need to file /pay for the preparation of one tax return);
- Administrative costs (increase or decrease) to state agencies for processing more income tax returns; and
- Administrative impact to employers in terms of changing withholding for cross-border employees.

If there is an impasse with Wisconsin about the timing of the income tax reciprocity payment, termination of the agreement is the other option that the Governor would consider. Under termination (effective tax year 2010), there would be a permanent gain in state income tax revenue. In the FY 2010-11 biennium, termination would result in an estimated one-time increase of $131 million or $25.6 million more than the proposal to modify or accelerate the timing of the reimbursement payments. In the FY 2012-13 biennium, an estimated $36.3 million is the amount of the on-going permanent revenue that would be gained by terminating reciprocity. There would also be a quantitative impact to taxpayers' income tax liability, taxpayer convenience, as well as an administrative impact to DOR and employers with termination of the agreement.[2]

Impact on Sales Tax Revenue for the Delay Capital Equipment Refunds

	FY 2010-11 Biennium	FY 2012-13 Biennium
Revenue Impact	$63.000 million	($63.100 million)

Businesses generally pay sales tax when they buy or lease capital equipment, but they can apply for a full refund of any tax paid on purchases of qualified capital equipment.[3] The proposal is to temporarily delay one-quarter of the capital equipment sales tax refund payments to realize $63 million in savings for FY 2011. Refunds would be delayed no more than 3 months and would be immediately released in the next fiscal year. This shift will be paid back in FY 2012 with interest and the cost will be embedded in the Minnesota Management and Budget (MMB) financial forecast as higher refund payments.

On average, the general fund revenue reduction from the payment of sales tax refunds on capital equipment is about $250 million per year over the four year period (FY 2008 to FY 2011). Under the proposal, about $63 million in refunds or about one-quarter of the total capital

[2]Minnesota statute 290.081 authorizes the Commissioner of Revenue to enter into income tax reciprocity agreements with other states but also gives the Commissioner the authority to terminate the agreement if that is deemed in the best interest of the state. On September 18, 2009, in the absence of a re-negotiated agreement, the Governor terminated the income tax reciprocity with the state of Wisconsin, effective tax year 2010. Termination of the agreement is estimated to result in $131.3 million in the FY 2010-11 biennium. For more information on the Minnesota-Wisconsin income tax reciprocity agreement, see the Issue Brief at: http://www.house.leg.state.mn.us/fiscal/files/ibmnwitx0909.pdf

[3] Business machinery and equipment that is exempt from sales tax at the time of sale include farm machinery, logging equipment, telecommunication equipment, accessory tools and special tooling, air flight equipment sold to airlines and ski area equipment.

equipment refunds would be delayed in FY 2011. Refunds scheduled to be paid after March 31, 2011 would be delayed until July 1, 2011 (and paid FY 2012). Minnesota is also statutorily required to pay interest on capital equipment refunds that are delayed more than 90 days. As such, DOR is assuming that the additional interest accrued due to the delay is estimated to be $100,000. So in total by FY 2012, DOR estimates that $63.1 million or $63.0 million in delayed refunds plus $100,000 in additional interest will be paid out in FY 2012 as higher refunds.

In terms of taxpayer impact, preliminary data from the Minnesota Tax Expenditure report shows how there are roughly 2500 capital equipment refund claims per year. If one-quarter of the receipts are delayed in FY 2011, we can assume that about 625 refund claims from taxpayers would be affected.

In 2003, the Governor directed DOR to delay capital equipment payments for 3 months, thereby shifting $50 million in payments from FY 2003 to FY 2004. This delay was accomplished as an administrative action related to unallotment.

Impact on Corporate Franchise Tax Revenue for of Delay Corporate Franchise Tax Refund Payments

	FY 2010-11 Biennium	FY 2012-13 Biennium
Revenue Impact	$42.000 million	($42.040 million)

The proposal is to temporarily delay corporate franchise tax refunds in the last three months of FY 2011 to realize a $42 million savings in FY 2011. Refunds would be delayed no more than 3 months and would immediately be released in the next fiscal year. This shift is to be paid back with interest and the additional cost will be embedded in the MMB financial forecast as higher refund payments in FY 2012.

In general, companies that have overpaid corporate franchise tax will generally be refunded. Corporate taxpayers typically overpay taxes to build-up a tax credit for future years. In a year when companies are operating with larger-than-expected losses, these tax credits can be converted into cash flow (as tax refunds) for cash-strapped businesses.

Data from the 2008 Budget Trends Study Commission reported that Corporate Franchise Tax is the most volatile of the state's three major sources of revenue and that it is extremely sensitive to economic cycles and thus subject to substantial uncertainty. Contributing to this volatility is that 90 percent of corporate franchise taxes are paid by 10 percent of Minnesota companies.

In the last three months of FY 2008, DOR paid $18.6 million in corporate tax refunds to 861 filers and $20.0 million in 2009 to 1,198 filers for the same period in FY 2009. The Governor has announced the delay of $42 million in corporate tax refunds in the last three months of the FY 2011, which is almost double the amount of tax refunds paid out in the last three months of FY 2008 or FY 2009. Any delay in tax refunds in FY 2011 will be paid back in FY 2012 with interest.

Interaction Impact on Individual Income Tax and Corporate Franchise Tax Revenue with Reductions to Local Government Aids and Credit Programs.

	FY 2010-11 Biennium	FY 2012-13 Biennium
Revenue Impact	($6.193 million)	($1.000 million)

The unallotments for local aids and credits create an individual income tax and corporate franchise tax interaction impact. The total unallotment reductions are discussed in the local aids and credits section of this summary and are only referenced here because these reductions are assumed to increase homeowner property taxes. If homeowner property taxes are increased, the net effect to the state is increased income tax and corporate franchise tax deductions. As such, general fund tax revenues are expected to decrease by $10.132 million from FY 2010 to FY 2013, contingent on CY 2009 and CY 2010 unallotments actually occurring as announced.

For additional information on tax revenues, contact Cynthia Templin at 651-297-8405 or cynthia.templin@house.mn .

Local Aids and Credits Unallotments

Changes in General Fund Expenditures

On July 1, the Governor unallotted funding for local tax aids and credits by $375.3 million, or about 10.9 percent, for the FY 2010-2011 biennium. These changes are reflected in six budget items and three adjustments, impacting all categories of this budget. For fiscal years 2010 and 2011, end-of-2009 session appropriations are cut as follows: tax refunds are reduced by $63.9 million (-6.2 percent), local aids are reduced by $248.5 million (-13.9 percent), and property tax credits are reduced by $62.9 million (-10.6 percent).

House Tax Aids and Credits
General Fund Spending - 2009 Session Plus Governor's Unallotments, FYs 2010-2011
(Dollars in Thousands)

	Actual FY 2008-09	Feb 2009 Fcst FY 2010-11	2009 Session FY 2010-11	Gov's Unallotmts FY 2010-11	Percentage Change Gov FY 2010-11 vs. FY 2008-09	Percentage Change Gov vs. 2009 Session FY 2010-11
Tax Refunds						
Homeowner Property Tax Refund	499,480	594,800	594,792	594,792	19%	0.0%
Renter Property Tax Refund	331,618	369,700	369,700	318,900	-4%	-13.7%
Property Tax Refund Interaction	0	0	0	2,757	-	-
Political Contribution Refund	10,938	11,200	11,200	800	-93%	-92.9%
Sustainable Forest Land Payments	10,952	16,213	16,213	10,713	-2%	-33.9%
Other Refunds	33,994	33,160	33,160	33,160	-2%	0.0%
Subtotal Refunds	**886,982**	**1,025,073**	**1,025,065**	**961,122**	**8%**	**-6.2%**
Local Aids						
Local Government Aids[1]	915,269	1,066,327	1,066,327	919,463	0%	-13.8%
County Program Aids[2]	367,303	460,218	460,718	360,718	-2%	-21.7%
Local Pension Aids	208,908	217,272	217,272	217,272	4%	0.0%
Other Local Aids	38,982	41,870	41,870	40,271	3%	-3.8%
Subtotal Aids	**1,530,462**	**1,785,687**	**1,786,187**	**1,537,724**	**0%**	**-13.9%**
Property Tax Credits						
Homestead Market Value Credit	531,659	528,853	528,853	467,557	-12%	-11.6%
Agricultural Market Value Credit	50,123	49,223	49,223	47,807	-5%	-2.9%
Senior Property Tax Deferral	896	1,382	1,407	1,407	57%	0.0%
Other Credits	13,896	16,331	16,331	16,107	16%	-1.4%
Subtotal Credits	**596,574**	**595,789**	**595,814**	**532,878**	**-11%**	**-10.6%**
Taconite Tax Relief Aids & Credits	**28,653**	**28,715**	**28,715**	**28,715**	**0%**	**0.0%**
Other Expenditures	**1,156**	**131**	**1,764**	**1,764**	**53%**	**0.0%**
TOTAL TAX AIDS & CREDITS[3]	**$3,043,828**	**$3,435,395**	**$3,437,545**	**$3,062,203**	**1%**	**-10.9%**
Difference Actual 08-09 v Feb 09 Fcst	--	**$391,567**				
Difference Feb 09 Fcst v EOS 2009		--	**$2,150**			
Difference EOS v EOS + Gov Unallot			--	**($375,342)**		

Notes: Negative numbers represent expenditure reductions (budget savings) and positive numbers represent expenditure increases.
[1] Local Government Aids includes Local Government Aid, Utility Aid and Mahnomen City Aid
[2] County Program Aids includes County Program Aid, County Transition Aid, and Beltrami and Mahnomen County Aids.
[3] Total includes the impact of Executive action K-12 shifts but does not include the $6.28 million ($10.15 million less $3.87 million unallotment) transfer to Dedicated Account in FY 2011.

In general, these changes are reminiscent of the Governor's February 2009 proposed funding reductions for tax aids and credits presented earlier this year, save two items – Taconite Replacement Aid and Department of Natural Resources Payment-in-lieu-of-taxes (PILT). However, unlike his February 2009 recommendations, which if enacted would have significantly reduced spending for fiscal years 2010-13, 97 percent of the Governor's unallotments impact only the FY 2010-11 biennium.

Specifically, the Governor's July 2009 unallotments and executive actions target spending accounts as follows:

- **Reduces the Renters Property Tax Refund** by $50.8 million beginning in FY 2011;
- **Eliminates funding for the Political Contribution Refund** program beginning in FY 2010, which generates a savings of $10.4 million over the biennium;

- **Caps Sustainable Forest Land payments** for a savings of $5.5 million beginning in FY 2011;
- **Reduces Local Government Aid** beginning in FY 2010 for a cost savings of $147.0 million over the biennium;
- **Reduces County Program Aid** beginning in FY 2010 for a cost savings of $100 million over the biennium;
- **Reduces Market Value Credit** (Residential and Agricultural) beginning in FY 2010 for a cost savings of $53.0 million over the biennium;
- **Creates Property Tax Interactions** beginning in FY 2011 that increase spending by $2.8 million,
- **Reduces Property Tax Aids and Credits to school districts** by shifting $11.4 million in K-12 Education funding payments to FY 2012**,** and
- **Reduces the transfer to the Special Dedicated Account** (federal conformity) in FY 2011 by $3.9 million).

Further detail by item is given below.

The numbers shown in bold are Governor-approved unallotments for each biennium compared with end of 2009 Session appropriations.

Tax Refunds	**FY 2010-11**	**FY 2012-13**
Renter Property Tax Refund	**($ 50.8 million)**	**(-$0 -)**

Beginning in FY 2011, the Governor's unallotment reduces property tax refunds for eligible renters by lowering the rate of the refund, previously calculated at 19percent of rent paid, to reflect 15percent of rent paid. This reduction, based on a 2006 Department of Revenue study that shows property taxes to be an average 15percent of rent, is a 13.9percent decrease in spending for renter refund payments.

Under current law, a renter is eligible for a property tax refund based on the ratio of rent constituting property taxes to income. Income thresholds and maximum refund amounts are adjusted annually for inflation. For claims filed in 2008, the maximum income level for a renter was $41,820 and the maximum refund was $1,190. Approximately 304,900 renters filed a claim, with the average refund estimated at $570 (Table 1).

Table 1 **Baseline FY 2009** **Renter Property Tax Refunds**			
Gross Income Category	**Number of Filers**	**Total Amount All Filers**	**Average Refund**
$0-$10,000	69,150	$36,370,000	$528
$10,000 - $20,000	102,370	$63,940,000	$627
$20,000 - $30,000	75,875	$45,700,000	$604
$30,000 - $40,000	40,345	$20,180,000	$502
$40,000 to < $41,820	16,860	$7,610,000	$393
Total	**304,900**	**$173,800,000**	**$570**

Table 2
Unallotment of Renter Property Tax Refund Program
Reduce Property Tax % of Rent from 19% to 15%

February 2009 forecast*	**Filer Count**	**% of Total**	**Current Refunds**	**Proposed Refunds**	**Change**
Become ineligible for refund	18,200	6%	$1,460,000	$0	($1,460,000)
Remain eligible, reduced refund	280,900	92%	$164,550,000	$118,690,000	($45,860,000)
Max refund, no change	5,777	2%	$7,790,000	$7,790,000	$0
TOTAL	304,877	100%	$173,800,000	$126,480,000	($47,320,000)

* Estimates based on actual FY 2009 renter refunds, February 2009 forecast;
FY 2011 general fund savings = $50.8 million

Source: Department of Revenue

The Governor's unallotment (Table 2) will cause approximately 18,200 renters to become ineligible to receive a refund. In addition, 280,900 claimants will realize a reduced payment. The greatest portion of the decrease would impact more than 178,200 filers (or 58percent) with incomes between $10,000 and $30,000. The average decrease in refund for all filers is estimated to be more than $129 per claimant. Filers who are age 65 or older or who have a disability – about 28 percent of all filers – will experience a decreased refund of about $143. The cost savings of this proposal to the general fund would be $50.8 million in FY 2011.

Political Contribution Refund	**<u>FY 2010-11</u>**	**<u>FY 2012-13</u>**
	($ 10.4 million)	**(-$0 -)**

The Political contribution refund program allows a taxpayer to claim a refund equal to the amount of the taxpayer's contributions made in the calendar year to candidates and to a political party. The maximum refund for an individual must not exceed $50 and for a married couple, filing jointly, must not exceed $100.

Beginning in FY 2010, the Governor unallots funding for the political contribution refund program for a two-year period. On June 18, 2009, the Department of Revenue released a memo to clarify when and how the unallotment pertains to calendar year 2009 political contributions: *"Contributions physically received by the political committee or fund treasurer, candidate or worker by June 30, 2009, will qualify for the political contribution refund. Contributions received on or after July 1, 2009, will no longer qualify during the two-year elimination period."* The cost savings of this proposal would be $4.3 million in FY 2010, $6.1 million in FY 2011.

Sustainable Forest Land Payments	**<u>FY 2010-11</u>**	**<u>FY 2012-13</u>**
	($ 5.5 million)	**(-$0 -)**

Sustainable Forest Land payments provide reimbursements to counties for property tax relief to private landowners who practice long-term forest management investment in accordance with the Sustainable Forest Incentive Act (2001). For two biennia, this program has been among the fastest growing programs in state government with increases of 35.8 percent (FY 06-07 to FY 08-09) and projected increases of 41.8 percent (FY 08-09 to FY 10-11). Over 710,600 acres are enrolled in the program for 2008.

Beginning in FY 2011, the Governor unallots funding for Sustainable Forest land payments, creating an impact equivalent to freezing the rate at $8.61 per acre and also capping payments at $100,000 per claimant per year.

Local Aids and Credits

Local Government Aid (LGA)	**<u>FY 2010-11</u>**	**<u>FY 2012-13</u>**
	($147.0 million)	**(-$0 -)**

Local Government Aid (LGA) provides annual, general-purpose funding to 763 of Minnesota's 854 cities. LGA funds are distributed according to "need factors" – measured differently for small cities (with populations of under 2,500 residents) versus large cities (with populations of 2,500 or more) minus the "ability to pay" measured by cities' tax base.

The Governor unallots funding for LGA by $44.6 million in FY 2010, or about 8.5 percent, and by $103.9.0 million or 19.4 percent in FY 2011. This reduction, along with reductions to the market value credit, seeks to distribute a fair-share of funding cuts to all cities and towns by using a formula based on a jurisdiction's levy plus aid. For aids payable in 2009 (FY 2010), city reductions equal 3.31 percent levy plus aid, and town reductions equal 1.74 percent. For aids payable in 2010 (FY 2011) city reductions equal 7.64 percent levy plus aid, and town reductions equal 3.66 percent. Jurisdictions with less than 1,000 residents and a below average tax base (approximately 454 small cities and 629 towns) will be held harmless from these cuts.

County Program Aid (CPA)	**FY 2010-11**	**FY 2012-13**
	($100.0 million)	**(-$0 -)**

The Governor unallots funding for CPA funding by $33.0 million in FY 2010, or about 14.5 percent, and by $67.0 million or 28.9 percent in FY 2011. This reduction, along with reductions to local government aid and market value credit, seeks to distribute a fair-share of funding cuts by using a formula based on a jurisdiction's levy plus aid. For aids payable in 2009 (FY 2010), county reductions equal 1.19 percent levy plus aid; for aids payable in 2010 (FY 2011), reductions equal 2.41 percent levy plus aid. Counties with 5,000 or fewer residents (there are five counties that qualify) will be held harmless from these cuts.

Homestead Market Value Credit	**FY 2010-11**	**FY 2012-13**
Cities	**($ 45.0 million)**	**(-$0 -)**
Towns	**($ 7.5 million)**	**(-$0 -)**
Agricultural Market Value Credit	**($ 0.5 million)**	**(-$0-)**
Total	**($ 53.0 million)**	**(-$0 -)**

The Homestead Market Value Credit program provides reimbursements to localities for property tax credits issued to owners of homestead residential property. Under this program, homeowners may receive tax credits equal to 0.4 percent of the market value of the parcel up to a maximum of $304, subject to a phase-out of the credit beginning at $76,000 in market value. The phase-out rate is equal to .09 percent of market value above $76,000 with no credit for homes valued at $414,000 and above. Approximately 1.3 million households participate in this program annually.

Beginning in FY 2010, the Governor unallots funding for the market value credit on homesteads and on homesteads located on agricultural land by eliminating annual reimbursements paid to townships ($2.5 million) and by reducing annual payments to 116 cities ($19.6 million). This reduction, along with reductions to local government aid and county program aid, seeks to distribute a fair-share of funding cuts by using a formula based on a jurisdiction's levy plus aid. In FY 2011, reductions to townships will total $5 million, and to cities $25.9 million. Cities would not be eligible for additional levy authority to replace these funds until FY 2011.

Other Tax Unallotments and Executive Actions

Property Tax Refund Interactions	**FY 2010-11**	**FY 2012-13**
	$ 2.8 million	**$ 6.6 million**

Reductions in state-provided aids and credits shift the tax burden to other sources, including local property taxes. Homeowners that pay higher local property taxes will also be eligible to receive enhanced property tax refunds.

Property Tax Aids Impacted by the	**FY 2010-11**	**FY 2012-13**
K-12 funding shift	**($ 11.4 million)**	**$ 11.4 million**

The Governor's unallotment includes changing the 90 percent current / 10 percent final payment schedule for school aid payments to a 73 percent current / 27 percent final payment basis. Most school aids are distributed through the K-12 part of the budget, six property tax aids or credits in the tax budget are distributed to school districts using to this formula. The savings in these accounts - Disaster Credit, Disparity Reduction Aid, Border City Credits, Prior Year Credits, Homestead Market Value Credits and the Agricultural Market Value Credit - collectively total - $11.6 million in FY 2010, $0.2 million in FY 2011 and $11.4 million in FY 2012.

K-12 Funding Shift from 90/10 to 73/27
Fiscal Impact by Budget Activity Level ($000s)

	July 2009			
	FY 2010	FY 2011	FY 2012	FY 2013
Disaster Credit	(5)	5	0	0
Disparity Reduction	(1,459)	0	1,459	0
Border City	(162)	(8)	170	0
Prior Year Credits	(54)	0	54	0
Homestead Market Value	(9,011)	221	8,790	0
Agricultural Land Market Value	(940)	0	940	0
Total K-12 Payment Delay	(11,631)	218	11,413	0
FY 2010-11 Biennium		(11,413)		
FY 2012-13 Biennium				11,413

Special Dedicated Account	**FY 2010-11**	**FY 2012-13**
	($ 3.8 million)	**$ 3.8 million**

Chapter 88 directs the commissioner of revenue to deposit up to $10.149 million in additional revenues received in FYs 2010-2011 into a special holding account. The Governor unallots $3.8 million of this transfer, due to occur at the end of FY 2011.

For additional information on property aids and credits, motor vehicle taxes and other taxes, contact Katherine Schill at 651-296-5384 or katherine.schill@house.mn .