

Background Briefing on Minnesota Taxes

MINNESOTA HOUSE RESEARCH AND FISCAL ANALYSIS DEPARTMENT

January 13, 2021



State Taxes

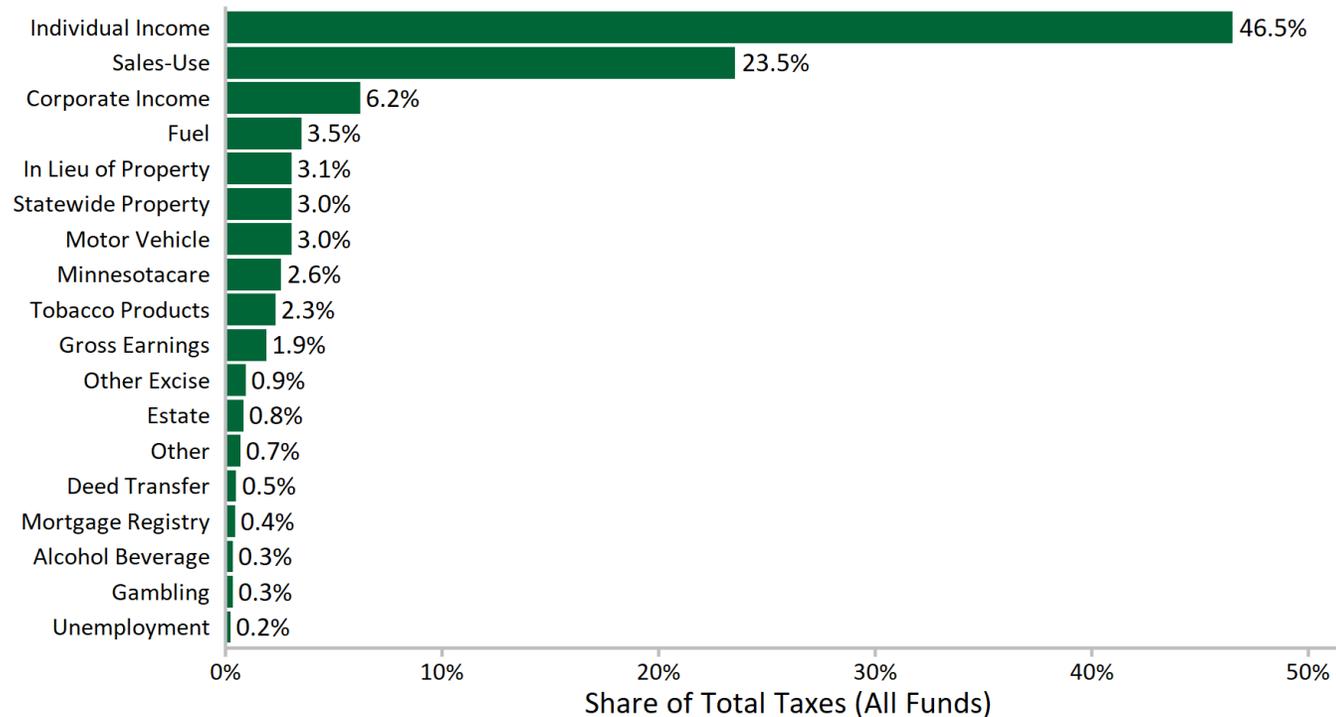
- Individual Income Tax
 - Sean Williams, House Research Department
- Sales Taxes
 - Alex Haigler, House Research Department
- Corporate Franchise Tax
 - Christopher Kleman, House Research Department
- Excise Taxes (Motor Fuels, Cigarette/Tobacco, Alcohol Beverage Taxes)
 - Alex Haigler, House Research Department
- Other Taxes (MNCare, Insurance, Estate, Mortgage & Deed, Lawful Gambling Taxes)
 - Alex Haigler & Christopher Kleman, House Research Department

Tax Revenues by Tax Type

Income and Sales are by Far the Largest State Taxes

Share of All Minnesota Taxes By Tax Type, FY 2019

Total Taxes are \$26.7 Billion



Graphic by MN House Research

Data from Minnesota Management and Budget. November 2020 Consolidated Fund Statement.

State Tax Revenues

Minnesota State Tax Collections \$26.7 Billion in Fiscal Year 2019

(Million \$)

Individual Income	\$12,405
Sales-Use	6,273
Corporate Income	1,660
Fuel	938
In Lieu of Property	814
Statewide Property	811
Motor Vehicle	810
Minnesotacare	687
Tobacco	620
Gross Earnings	505
Other Excise	249
Estate	225
Other Taxes	186
Deed Transfer	132
Mortgage Registry	117
Alcohol Beverage	93
Gambling	90
Unemployment	60

Table by House Research.
Data Compiled from Minnesota Management and Budget,
November 2020 Consolidated Fund Statement.

Fiscal Resources

- Revenue Estimates – Estimates by the Minnesota Department of Revenue (DOR) that provide analysis about how the bill language would change state tax collections or state expenditures for property tax relief programs
- Fiscal Notes – Provides estimates of administrative costs for relevant state agencies prepared under the of the Legislative Budget Office (LBO) with the assistance of all relevant state agencies
- Local Impact Notes – Estimates the local government or school district fiscal impact of proposed legislation or rule
- Legislative Budget Tracking Spreadsheet – Provides a compilation of cost information from revenue estimates, fiscal notes, and other sources for a bill or omnibus bill

Individual Income Tax

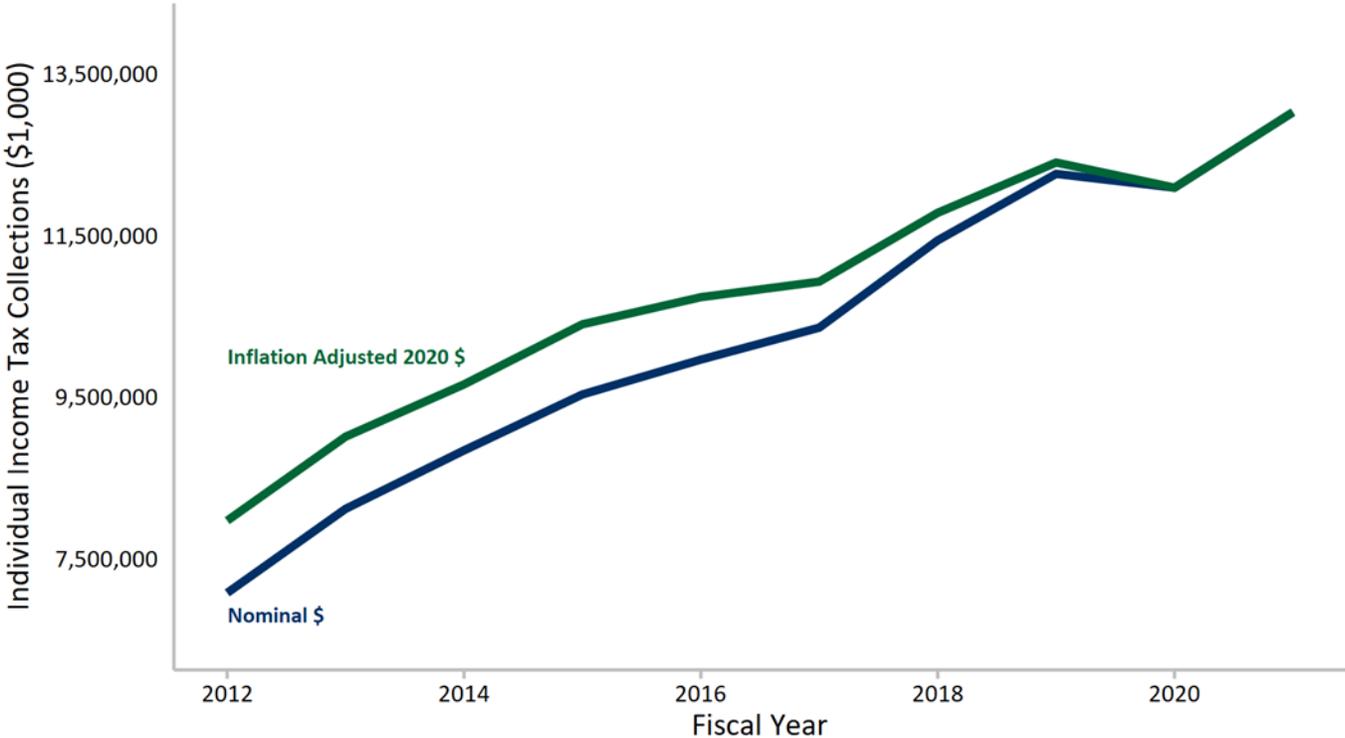
- Collected through withholding, estimated payments, and final payments
- Returns for the tax year filed following the close of the tax year
 - Due to the pandemic, the due date for tax year 2019 returns or final payment due on April 15, 2020 was extended to July 15, 2020.

Income Tax Revenue

- \$12.4 billion in actual collections for FY 2019
 - reciprocity with Wisconsin NOT in effect
- Roughly 47% of state tax revenue
- All goes to general fund

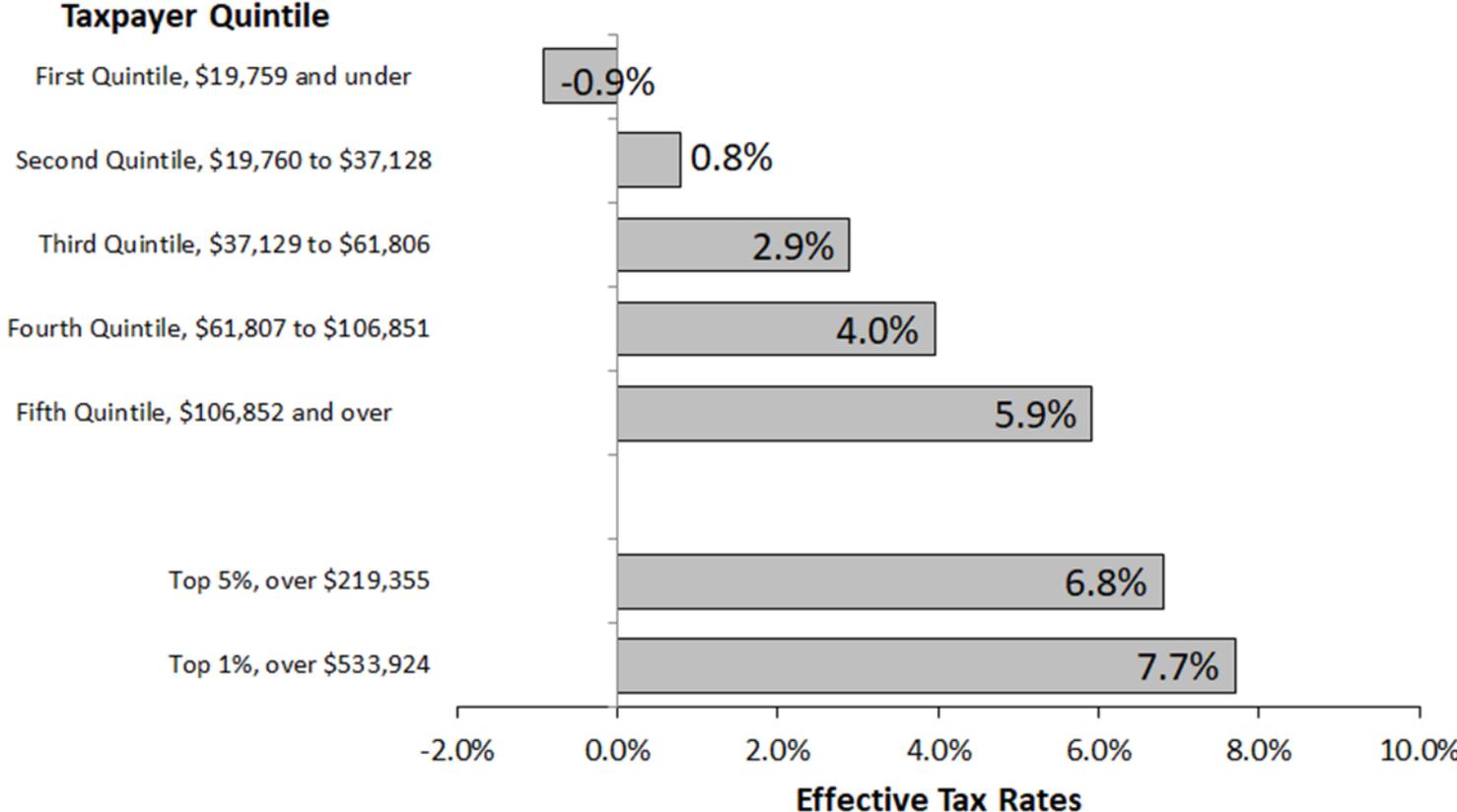
Historical Income Tax Collections

Income Tax Collections, FY 2012-2021



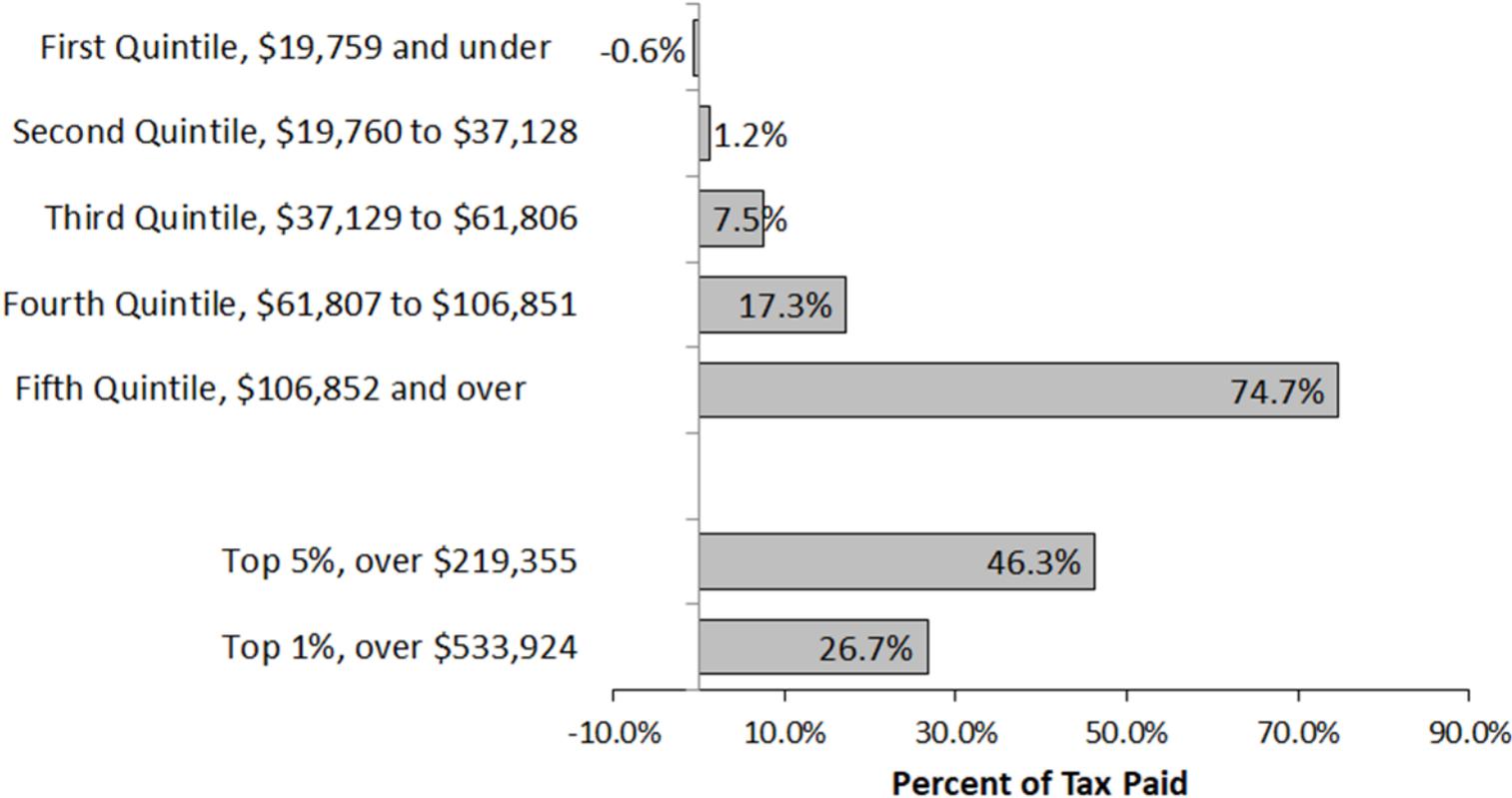
Data from Minnesota Management and Budget. Consolidated Fund Statements (Feb. 2012 - Nov. 2020). Amounts adjusted using the Consumer Price Index For All Urban Consumers (CPI-U). FY 21 Amounts are MMB Projections. Graphic by MN House Research.

Individual Income Tax: Effective Rates



Individual Income Tax: Who Pays the Tax

Taxpayer Quintile



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

House Research Department

- Nonpartisan staff; work with members of both parties on a confidential basis
- Provide House members and committees with legal and policy analysis and legislative research
- Draft bills and amendments
- Prepare bill summaries
- Modeling income tax, property tax, and state aids proposals
- Prepare publications on policy topics of legislative interest

Individual Income Tax

- Tax on income paid by individuals and “pass-through entities”:
 - Sole proprietorships
 - Partnerships
 - S-Corporations
 - Some limited liability corporations (LLCs)
- C-Corporations instead pay the corporate franchise tax

Individual Income Tax

$$\text{Tax Base} \times \text{Tax Rates} \\ = \text{Preliminary tax}$$

$$\text{Preliminary Tax} - \text{Tax Credits} \\ = \text{Final tax}$$

Definitions:

- **Tax Base:** Final income (after deductions) subject to tax
- **Tax Credits:** Tax preferences that directly reduce tax liability

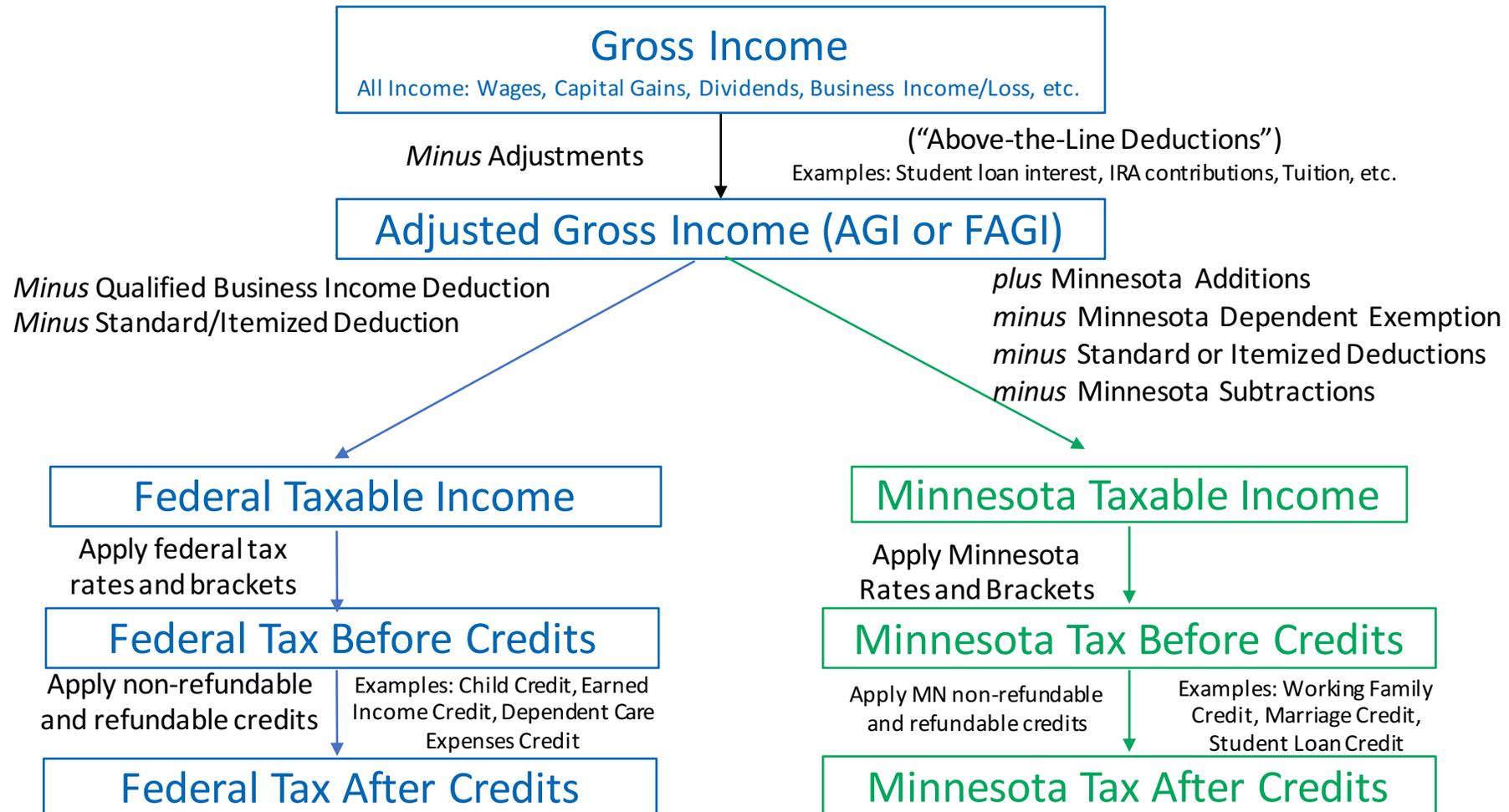
Choice for Legislators

- What tax base to use?
- What tax rates to use?
- What credits to allow?

Minnesota's Tax base: MN Taxable Income (MTI)

- Federal Adjusted Gross Income (FAGI)
- + Minnesota Additions
- Minnesota Dependent Exemption
- Standard or Itemized Deductions
- Other Minnesota Subtractions
- = Minnesota Taxable Income (MTI)

Federal-State Tax Relationship



Example Calculation, TY 2020

Family of 3, \$50,000 of wage income with student loan and child care expenses

Calculation Step	Item	Amount
Gross Income	Wages	\$50,000
- Adjustments	Student loan interest	-2,500
Adjusted Gross Income		\$47,500
-Minnesota Subtractions	K-12 Expense Subtraction	-1,625
-MN Standard Deduction		-24,800
-MN Dependent Exemption	1 Child	-4,300
+Minnesota Additions		0
Minnesota Taxable Income (Tax Base)		\$16,775
Minnesota Tax before credits		\$897
-Nonrefundable Credits	Student loan credit	-500
Minnesota Tax before refundable credits		\$397
-Refundable Credits	Dependent Care Credit	-600
Net Minnesota Tax Liability		-\$203

Conformity to Federal Law Changes

- Minnesota's tax system is built on the federal system.
- Federal laws and rules that affect FAGI also affect Minnesota liability. Most rules for calculating business income affect FAGI.
- Changes in federal rules are not automatically adopted; Minnesota is a “static date” conformity state. (Currently conformed through December 31, 2018.)

Choices for Legislators

- Which federal changes to conform to?
- Currently out of conformity with four federal acts:
 - Further Consolidated Appropriations Act (12/2019)
 - Families First Coronavirus Response Act (3/2020)
 - Coronavirus Aid, Relief, and Economic Security (CARES) Act (3/2020)
 - Consolidated Appropriations Act, 2021 (12/2020)

Choices for Legislators

- What additions to require? *(some required by federal law)*
- What itemized deductions to allow?
- What subtractions to allow? *(some required by federal law)*
- How to adjust for family size? *(current law allows a dependent exemption)*

MN Additions TY 2020

- Interest on other states' bonds
- Federal changes that we don't conform to

MN Subtractions TY 2020

(required by federal law)

- U.S. bond interest
- Railroad retirement benefits
- On-reservation earnings (by members of Indian tribes)

MN Subtractions 2020

- Timing issues: Expensing items recognized *earlier* under the federal tax, *later* under the state tax
 - Bonus depreciation
 - Net operating losses

MN Subtractions TY 2020

(state discretionary items)

<u>Subtraction</u>	<u>FY 21 Estimated Cost*</u>
Charitable contributions of nonitemizers	\$73.0 million
Portion of taxable Social Security Income	\$68.1 million
Military pension and retirement income	\$20.1 million
Active duty military service pay	\$18.5 million
Certain K-12 education expenses	\$16.7 million
Section 529 college savings plan contributions	\$5.5 million
National Guard and Reserve pay	\$4.3 million
Certain income of elderly or disabled persons	\$.6 million
Americorps education awards	\$.1 million
Certain discharged student loans	\$.1 million
Organ donation expenses	<\$50,000
Farm Property Disposition	<\$50,000
First-time homebuyer savings account interest	<\$50,000

*Cost estimates from the 2020 DOR Tax Expenditure Report.

MN Itemized Deductions, TY 2020

<u>Itemized Deduction</u>	<u>FY 21 Estimated Cost*</u>
Charitable contributions	\$107.3 million
Home mortgage interest	\$83.4 million
Real property Taxes	\$52.5 million
Medical expenses	\$52.2 million
Unreimbursed employee expenses**	\$10.7 million
Other taxes	\$1.4 million
Casualty and theft losses	\$1.0 million

*Cost estimates from the 2020 DOR Tax Expenditure Report.

**Unreimbursed employee expense deduction modeled using the House Income Tax Simulation (HITS) Model.

Minnesota's Tax Rates

<u>Tax Rate</u>	<u>2021 Income bracket (married joint filers)</u>
5.35%	\$0 to \$39,410
6.80%	\$39,410 to \$156,570
7.85%	\$156,570 to \$273,470
9.85%	Over \$273,470

Minnesota Tax Credits

(State discretionary items)

11 Nonrefundable credits

offset liability, but not to less than zero

9 Refundable credits

offset liability, with any excess paid as a refund (*eight of these*)

Nonrefundable Credits

<u>Credit</u>	<u>FY 21 Estimated Cost*</u>
Credit for taxes paid to another state	\$292.4 million**
Marriage penalty credit	\$84.8 million
Student loan credit	\$23.6 million
Research and development credit	\$32.6 million
	+\$8.4 million for C-Corps
Long-term care insurance premiums credit	\$9.5 million
College savings (529) credit	\$5.7 million
Credit for sales of agricultural assets to a beginning farmer	\$4.3 million
Beginning farmer management credit	\$1.0 million
Employer transit pass credit	\$0.9 million
Past military service credit	\$0.3 million
Credit for a teacher completing a master's degree	\$0.2 million

*Cost estimates from the 2020 DOR Tax Expenditure Report.

**Cost estimate from the House Income Tax Simulation (HITS) model, version 7.0

Refundable Credits

<u>Credit</u>	<u>FY 21 Estimated Cost*</u>
Working family	\$278.9 Million
Historic structure rehabilitation (sunsets after FY 21)	\$63.6 Million
Child and dependent care credit	\$26.7 million
K-12 education expense credit	\$8.6 million
Refundable credit for taxes paid to Wisconsin	\$7.3 million
Credit for military service in a combat zone	\$0.6 million
Credit for the parents of a stillborn child	\$0.4 million
Enterprise Zone credit	\$0.1 million
Small business investment credit ("Angel credit")	\$0.0 million, (\$10 Million in TY 2021 / FY 2022)

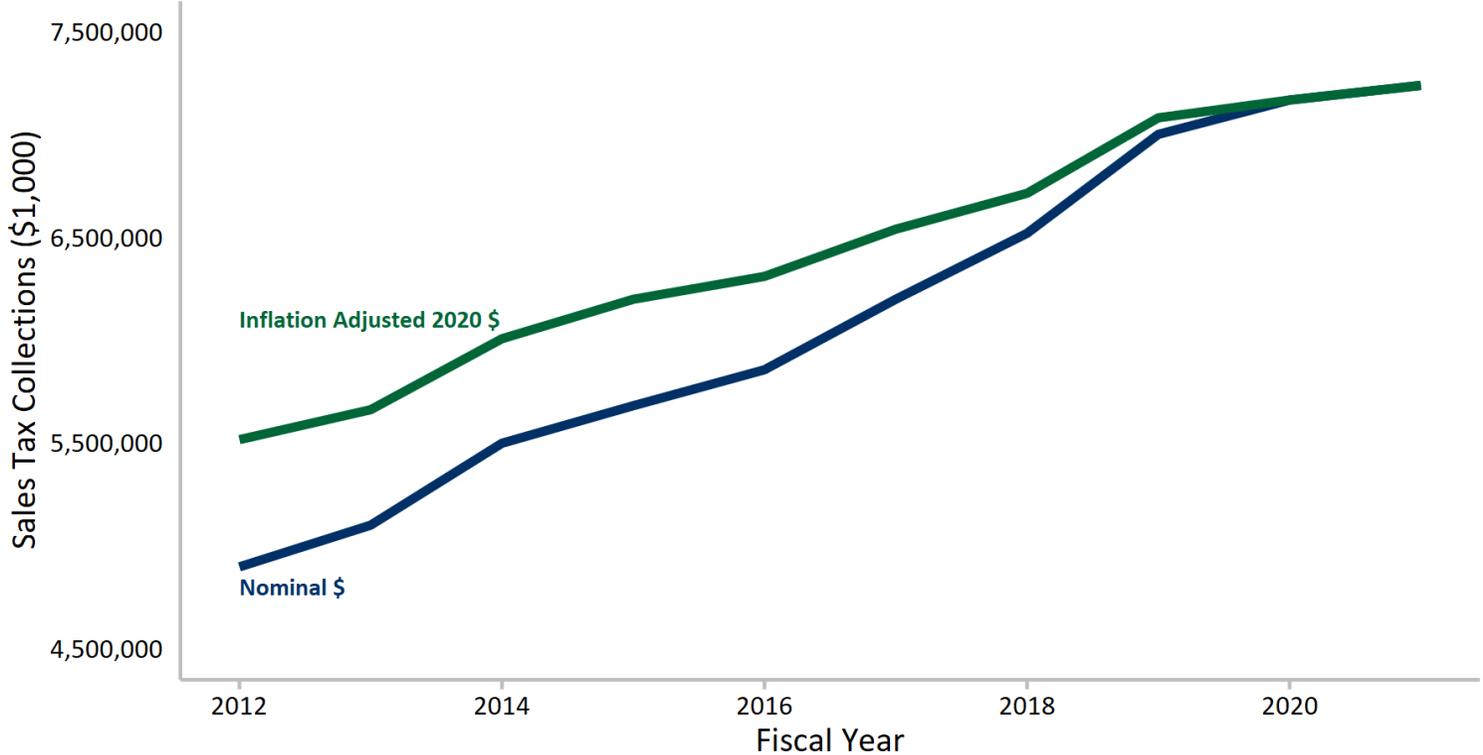
*Cost estimates from the 2020 DOR Tax Expenditure Report.

Sales Tax Revenue

- \$7.1 billion, actual collections for FY 2019
 - \$809.8 million is taxes on motor vehicle sales and leases
- Less than 1/3 of state tax revenue (27%)
- Business pays about 46% of the tax

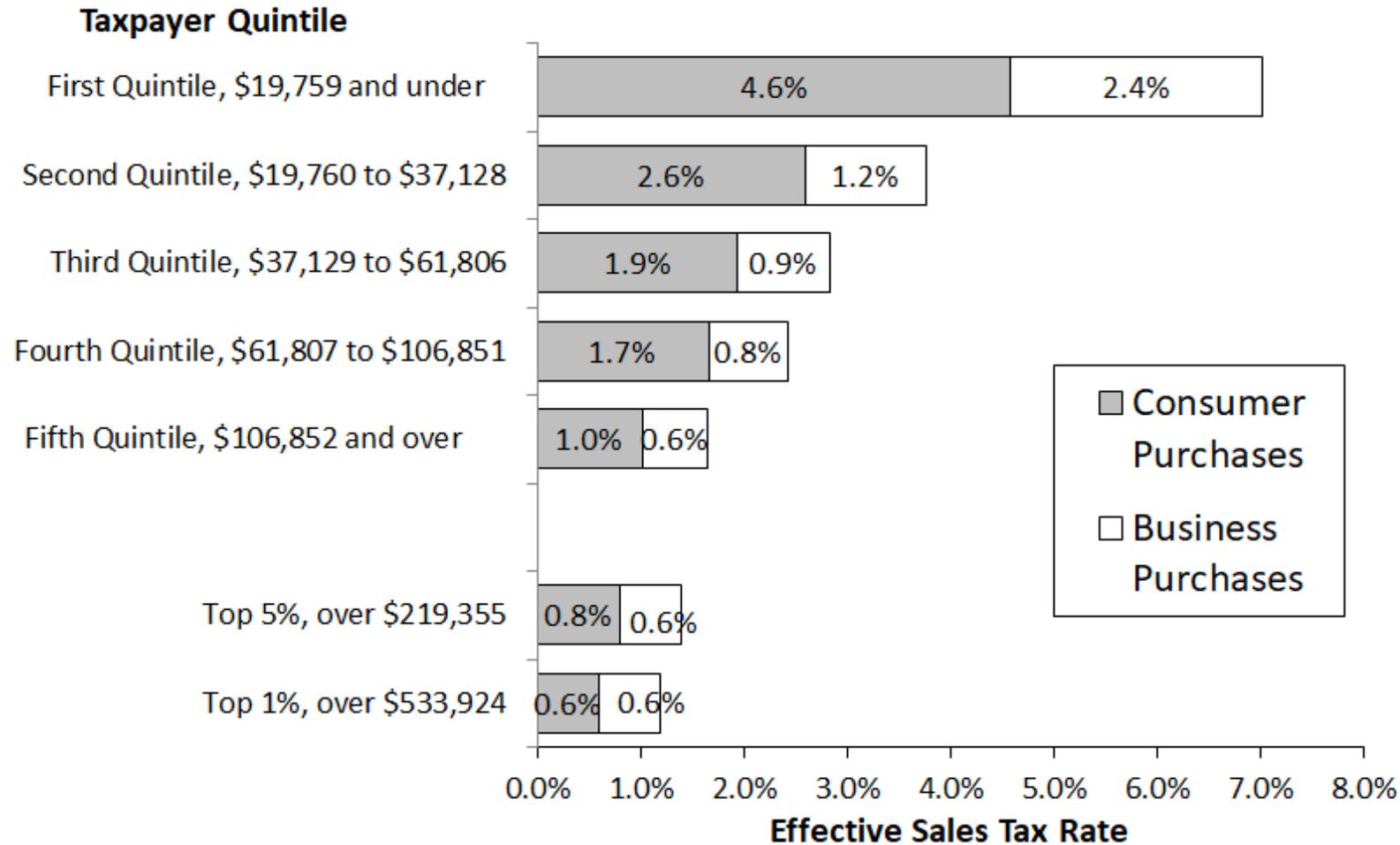
Historical Sales Tax Collections

Sales and Use Tax Collections, FY 2012-2021
All funds, including motor vehicle sales taxes.



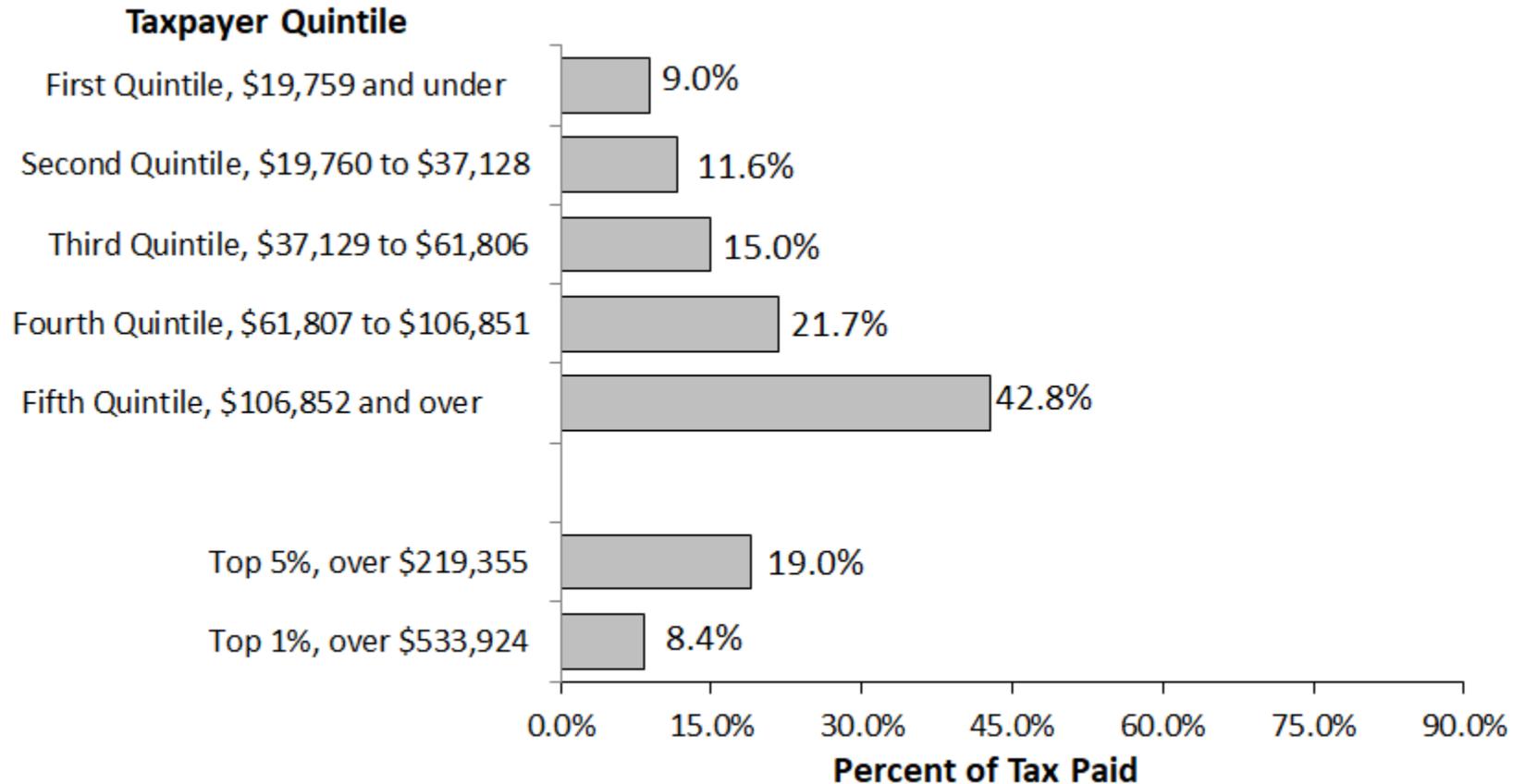
Data from Minnesota Management and Budget. Consolidated Fund Statements (Feb. 2012 - Nov. 2020).
Amounts adjusted using the Consumer Price Index For All Urban Consumers (CPI-U). FY 21 Amounts are MMB Projections.
Graphic by MN House Research.

Sales/Use Tax: Effective Rates



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Sales and Use Tax: Who Pays the Tax (Business & Consumer Purchases)



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Sales Tax Rates

- Total rate – 6.875%
 - General rate: 6.50%
 - Legacy amendment: 0.375%
 - Effective July 1, 2009, for 25 years
 - Constitutional dedication:
 - 33% to the outdoor heritage fund
 - 33% to the clean water fund
 - 14.25% to the parks and trails fund
 - 19.75% to the arts & cultural heritage fund
 - Actual revenue in FY 2019 - \$335.5 million

Sales Tax Base

- Goods (personal property) are taxable unless specifically exempted
- Services and intangibles are not taxable unless specifically included. Examples of taxed items:
 - lodging
 - cleaning services
 - digital downloads
 - telecommunications

Major Exemptions

For Individuals

- Food
- Clothing
- Home heating fuels
- Drugs for human consumption
- Newspaper & magazine subscriptions
- Cigarettes (in lieu sales tax)

For Businesses/Entities

- Capital equipment
- Farm machinery
- Certain direct inputs to agricultural and industrial production
- Certain purchases by data centers

Others

- Most sales to federal and local government (sales to the state government are still taxable)
- Many sales to nonprofit charitable, religious, educational, and youth organizations
- Certain sales by nonprofits

Sales Tax and Remote Sales

- The June 2018 Supreme Court case *South Dakota v. Wayfair* allows states to require remote sellers to collect sales taxes if certain conditions are met.
- Most remote sellers required to collect Minnesota tax starting October 1, 2018.
- Membership in the Streamlined Sales and Use Tax agreement facilitated state imposition.

Special Sales Taxes

- Short term rental motor vehicles: 21.075%
- Manufactured housing and park trailers: 6.875% on 65% of the cost
- Motor vehicle sales tax: 6.5%

Distribution of Sales Tax Revenues

- Most of the revenues go to the general fund except the following:
 - Motor vehicle sales tax
 - Tax on motor vehicle leases
 - Taxes on rental vehicles (both 6.5% tax and 9.2% tax)
 - Tax on auto parts (partial)
 - Tax on fireworks
 - Tax on general aviation aircraft parts
 - Lottery in-lieu payments (partial)
 - Revenue from the Legacy amendment rate (0.375%)

Local Sales Taxes

Local Option Sales Taxes (LOST)

- Projects with regional significance
- Resolution and proposals due to committee leads by Jan. 31
- Legislative approval
- Voter approval

County Transportation Sales Taxes

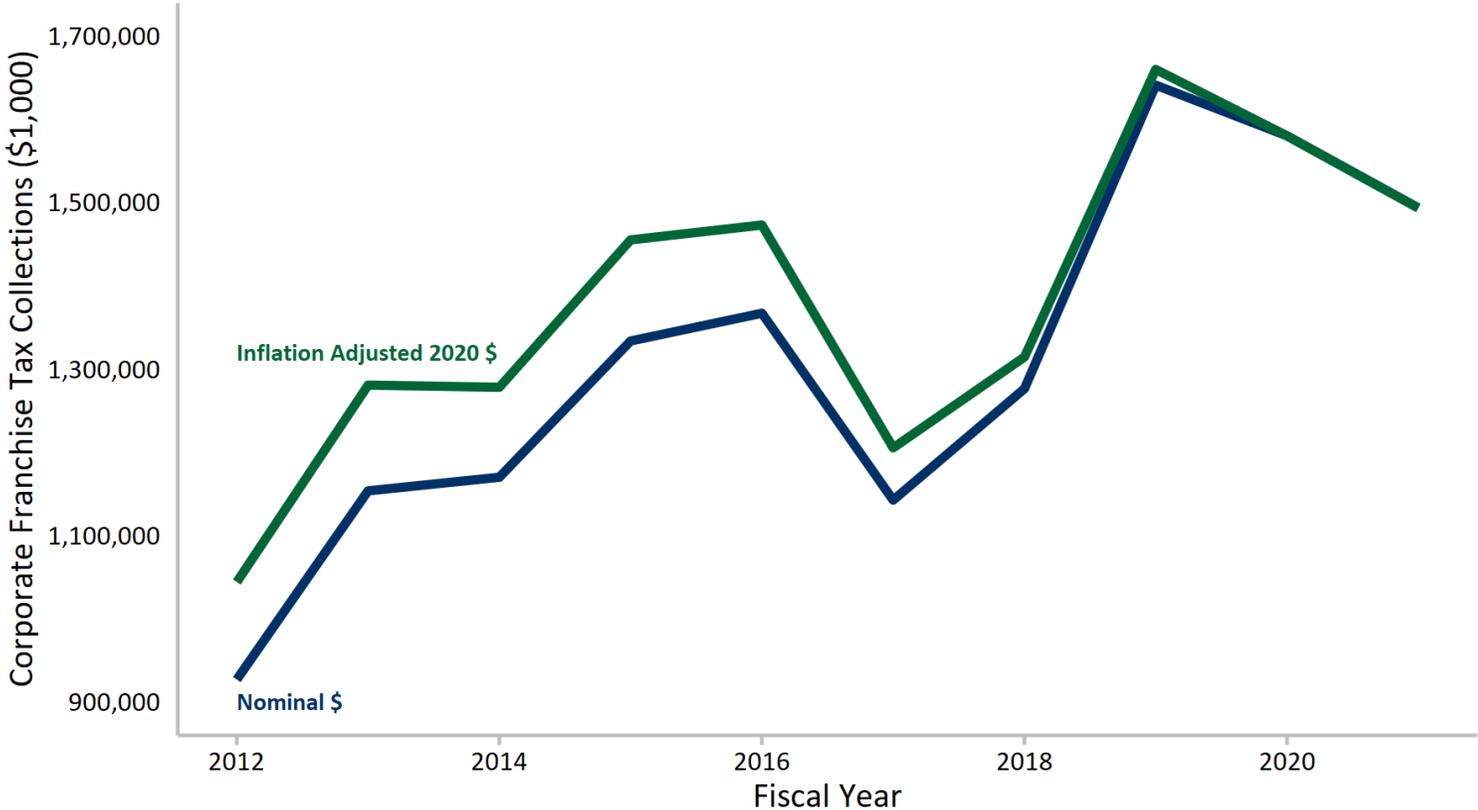
- 0.25% - 0.50%
- Used for transportation projects
- Voter approval not required
- 52 counties impose as of Jan. 2021

Miscellaneous

- Lodging taxes
- Food and Beverage taxes
- Entertainment taxes

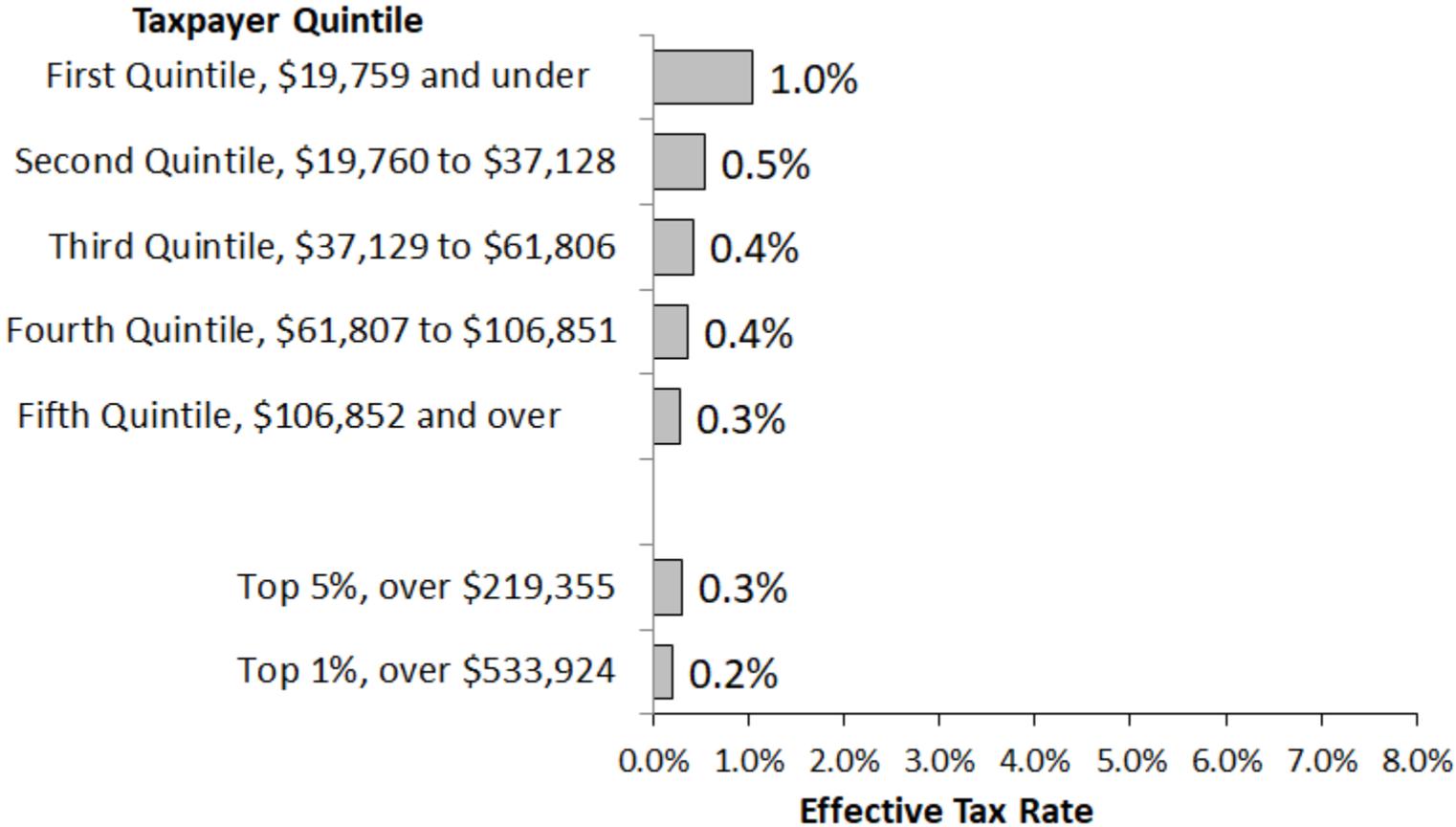
Historical Corporate Franchise Tax Collections

Corporate Franchise Tax Collections, FY 2012-2021



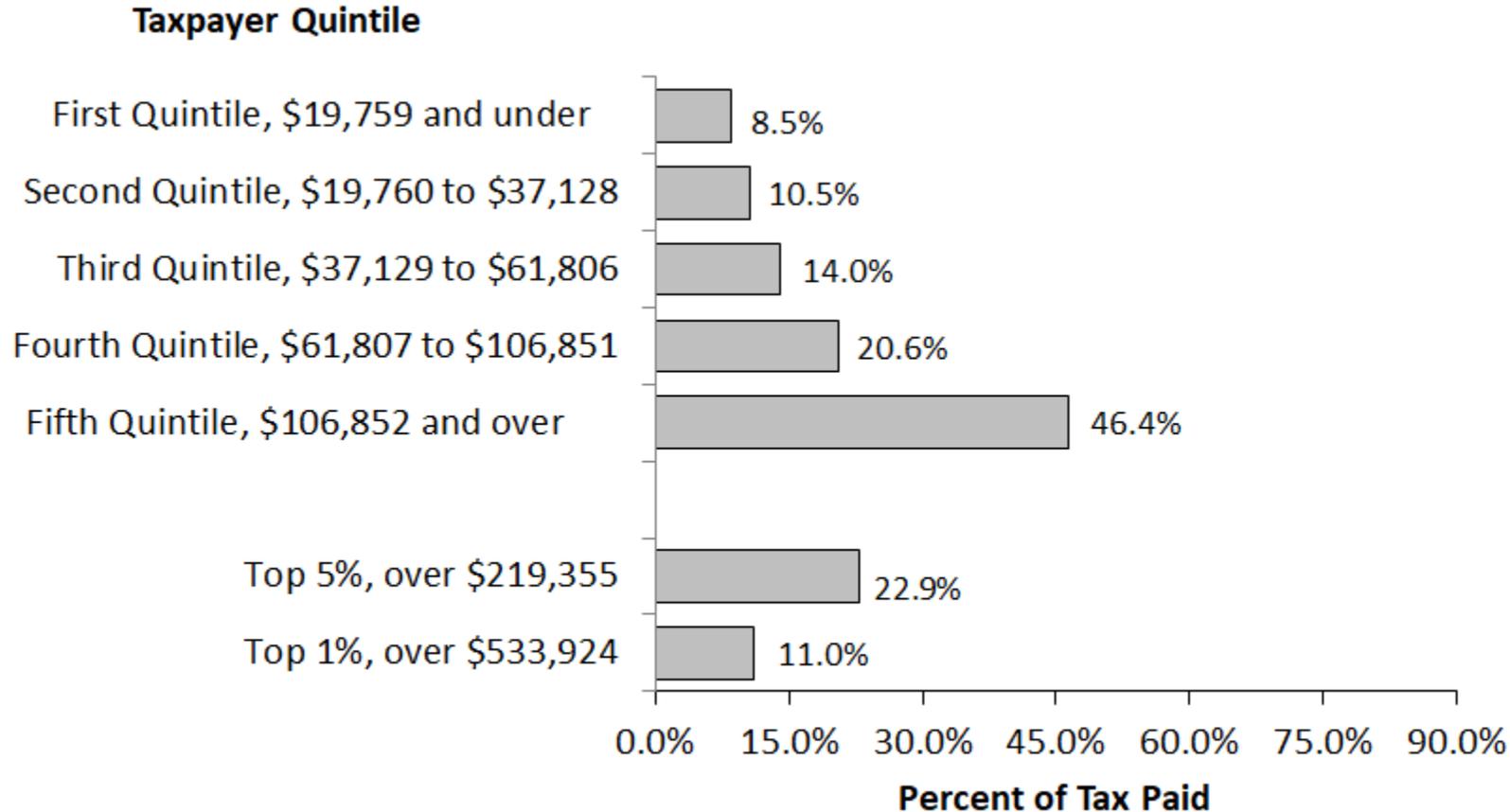
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Effective Corporate Tax Rates



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Corporate Tax: Who Pays the Tax



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Corporate Franchise Tax

- Tax base is (largely) the profits of “C” corporations
- Multi-state corporations use 100% sales apportionment; this favors corporations with more operations in Minnesota
- Tax rate of 9.8%

Corporate Franchise Tax

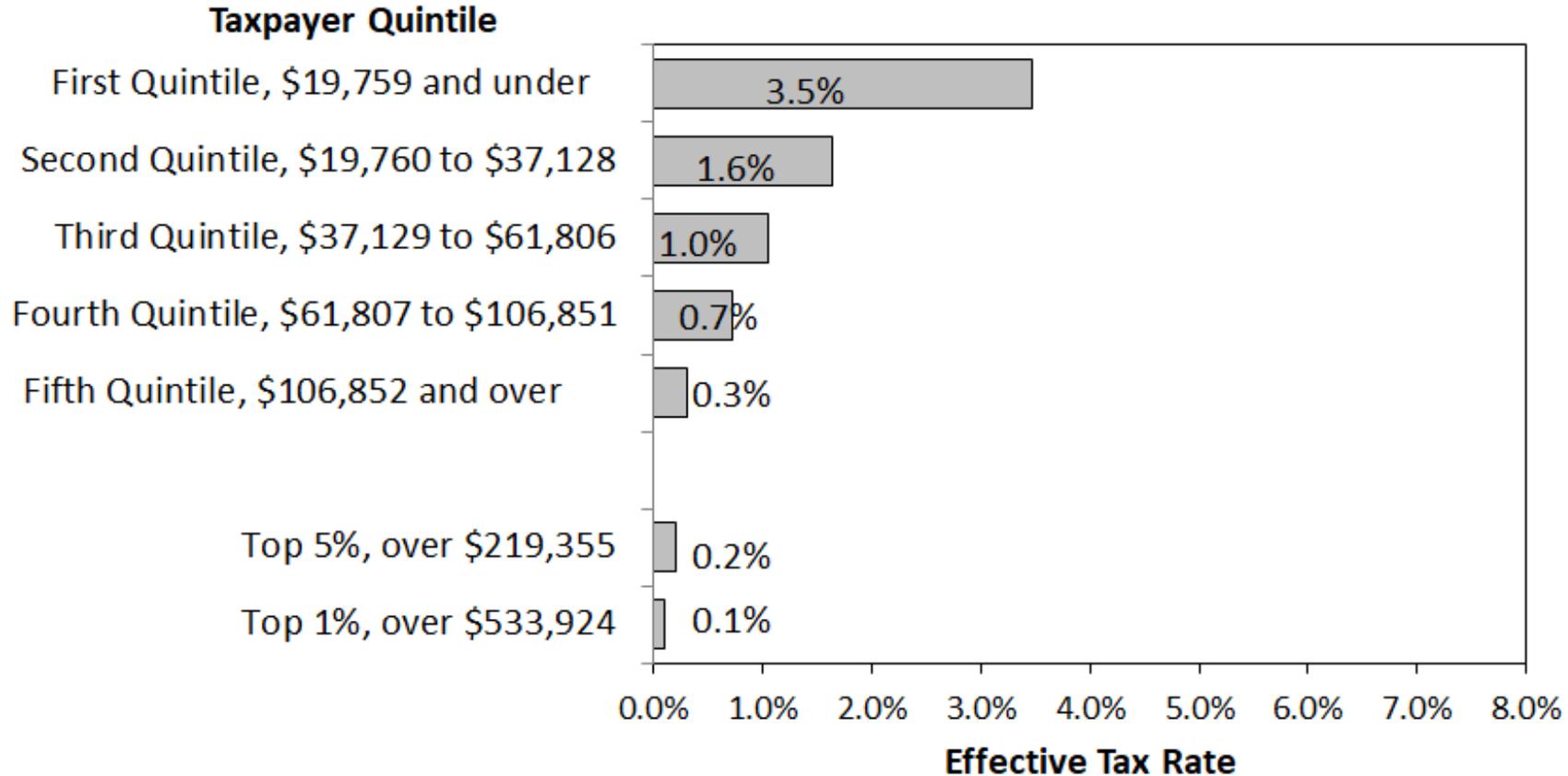
- Credits allowed for
 - Research & development
 - Transit passes
 - Historic structure rehabilitation
- Minimum fee applies to all businesses, including S corporations and partnerships

Corporate Franchise Tax

- \$1.7 billion, actual revenue, in FY 2019
- Most volatile revenue source of the major taxes –
 - \$529 million in FY 2002
 - \$1,171 million in FY 2007
 - \$663 million in FY 2010

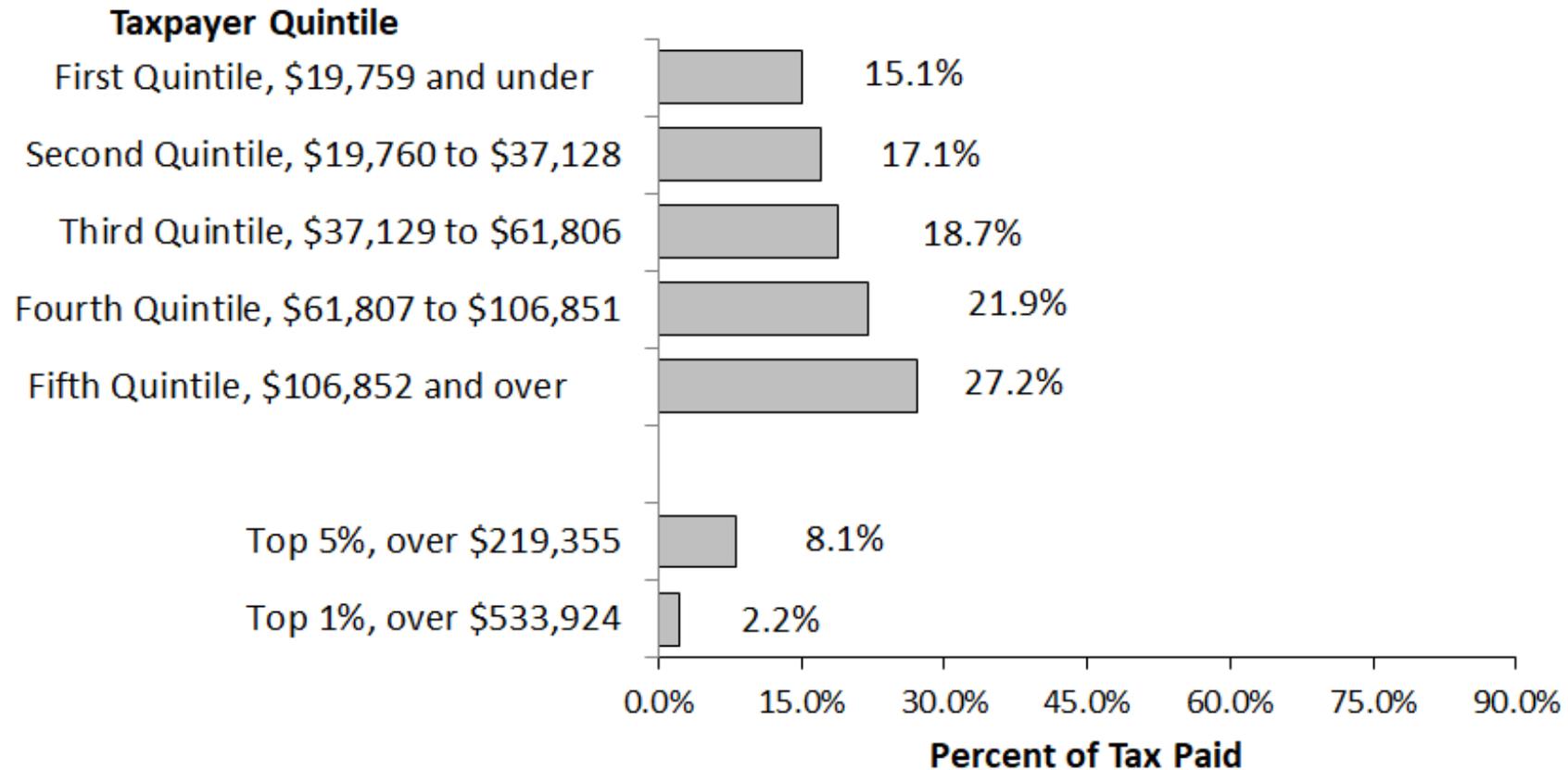
Excise Taxes: Effective Rates

(fuels, cigarette, & liquor)



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Excise Tax: Who Pays the Tax



Source: Minnesota Dept. of Revenue, 2019 Tax Incidence Study

Motor Vehicle Related Taxes

Fuel Tax

- Imposed on motor fuels used by vehicles on public highways
- Rate: 28 cents/gallon (base + debt service surcharge)
- Revenue constitutionally dedicated
- FY19 \$938 million

License Tax (tabs)

- Rate: 1.25% base value
- Revenue dedicated to highway user fund
- FY19 \$804 million

Cigarette and Tobacco Tax

- Tax on cigarettes is a per unit tax, while the tobacco products tax is a percent of the price
- For cigarettes, the excise tax rate is \$3.04 per pack of 20, and the in-lieu sales tax is \$0.63 per pack; 95% of wholesale price for tobacco products

Cigarette and Tobacco Tax

- \$593.3 million in FY 2019 (including fees)
- About \$26 million of the revenues dedicated to health research
- 50 cents/pack fee applies to nonsettlement cigarettes (about \$7.7 million of the revenue)

Alcoholic Beverage Excise Taxes

- Taxes are per unit of the beverage
- Tax rates vary by beverage type:
 - \$5.03/gallon for distilled spirits;
 - \$.30/gallon for table wine;
 - \$.15/gallon for strong beer; and
 - \$.08/gallon for 3.2 beer
- \$92.8 million, actual collections, in FY 2019

Alcoholic Beverage Gross Receipts Tax

- Functions like a retail sales tax on both on-sale and off-sale purchases of liquor, wine, and beer (including 3.2 beer)
- Replaced high general sales tax rate on these purchases to comply with SSUTA
- \$98.6 million in FY 2019 (receipts also reflected in MMB's sales tax revenues)

Mortgage Registry Tax

- Tax imposed on principal debt secured by mortgage of real property in state
- Rate is 0.23 percent of principal debt
- Collected by lender, paid to county treasurer where property is located
- Distribution: State 97%; County 3%
- FY 2019 revenue: \$117.1 million (actual)

Deed Transfer Tax

- Tax imposed when real estate is transferred (contracts for deed exempt)
- Rate is 0.33 percent of consideration
- Paid by person who transfers property, to county treasurer where property is located
- Distribution: State 97%; County 3%
- FY 2019 revenue: \$131.8 million (actual)

Lawful Gambling Taxes

- Tax imposed on gross receipts minus prizes paid
- The rate for paper bingo, raffles, and paddlewheels is 8.5%
- For pull-tabs, linked bingo, and tipboards, the rate starts at 9% and increases up to 36%
- \$88.7 million (actual revenue) in FY 2019

MinnesotaCare Taxes

- Tax base is gross revenues of health care providers
- Tax rate is 1.8%
- Medicare and federal employees health programs are exempt
- Revenues are used to fund the MinnesotaCare and Medical Assistance programs
- \$687.2 million, actual tax collections in FY 2019

Insurance Premium Tax

- Tax base is gross premiums
- Basic tax rate is 2%. Lower rates apply to some mutual companies
- Does not apply to fraternal benefit societies
- 1.5% rate applies to life insurance
- 1% rate applies to HMOs and nonprofit health service plan corporations

Insurance Premium Tax

- Retaliatory tax applies
- Federal law allows discrimination against interstate commerce
- \$505 million in FY 2019
- Portions of the tax are dedicated – MinnesotaCare; police and fire pension aid
- Insurance companies that pay are exempt from corporate franchise tax

Estate Tax

Tax is based on federal law rules

- Pick-up tax from 1986-2001 – reduced federal tax dollar-for-dollar
- Tax is now “stand-alone” tax
- Deductible in computing federal estate tax

Estate Tax

- Tax is based on market value of estate, less
 - Transfers to surviving spouse
 - Charitable bequests
 - Exemption amount is \$3 million for 2020 and later
 - Exemptions for qualified small business and farm properties of \$2 million in 2020 and later
- Tax rates range from 13% to 16%

Estate Tax

- \$224.9 million, actual collections in FY 2019
- Very volatile tax (\$216 million in FY 2006; \$54 million in FY 2001)
- 33 states (including ND, SD, WI) have no taxes for decedents dying in 2019
- Effect on domicile decisions?
- Progressive: Suits index of 0.847