VARIOUS TAXES

March 22, 2010

	Yes	No
DOR Administrative Costs/Savings	X	

Preliminary Estimates

State Taxes Only – See Separate Analysis for Property Tax Provisions

Department of Revenue
Analysis of H.F. 2695 (Lenczewski) As Proposed to be Amended (H2695DE2)

	Fund Impact			
	F.Y. 2010	**F.Y. 2011**	**F.Y. 2012**	**F.Y. 2013**
	(000's)			
Small Business Investment Tax Credit	$0	($9,000)	($9,000)	($8,900)
Appropriation to Department of Revenue for Study	$0	$0	$0	($100)
Historic Structure Rehabilitation Credit / Grant	$0	($3,800)	($8,100)	($8,100)
Eliminate Dividend Deduction for REIT Dividends	$0	$1,000	$1,000	$1,000
Create Automotive Recovery Zone (CARZ)				
Corporate Franchise Tax Exemption	$0	$0	$0	$0
Sales and Use Tax Exemption	$0	$0	$0	$0
Jobs Credit	$0	$0	$0	$0
Property Tax Refund	$0	$0	$0	$0
Income Tax – Personal Exemption Phase-out and Itemized Deduction Limitation	$0	$76,600	$0	$0
Transfer to Special Revenue Fund	$0	($76,600)	$0	$0
Transfer from Special Revenue Fund	$0	$15,200	$15,200	$15,200
General Fund Total	$0	$3,400	($900)	($900)
CARZ – Sales and Use Tax Exemption **Natural Resources & Arts Funds**	$0	$0	$0	$0
Transfer from the General Fund	$0	$76,600	$0	$0
Transfer to the General Fund	$0	($15,200)	($15,200)	($15,200)
Special Revenue Fund Total	$0	$61,400	($15,200)	($15,200)
Total – All Funds	$0	$64,800	($16,100)	($16,100)

EXPLANATION OF THE BILL

Small Business Investment Tax Credit
Effective beginning with tax year 2010 and expiring after tax year 2014, a refundable credit against the corporate franchise tax or the individual income tax would be allowed for investments made in a qualified small business or made by a qualified angel investment network fund. The investment can be made directly by a qualified taxpayer or through a qualified angel investment network fund that invests in a qualified small business.

Qualified taxpayers must make direct investments of at least $10,000 or $50,000 if through an investment network. The tax credit equals 25% of a taxpayer's investment, and it can be claimed in the year of the investment. The maximum credit per year is $250,000 for married-joint returns and $125,000 for other filers. The bill specifies the qualifications for a qualified small business, a qualified angel investment network, and a qualified taxpayer.

Tax credits are limited to $4.5 million in tax year 2010. Tax credits are increased to $9 million per year for the tax years 2011 to 2014, but $100,000 of the fiscal year 2013 amount is appropriated to the Commissioner of Revenue for a study to evaluate the impact of the credit.

Historic Structure Rehabilitation Credit or Grant
Effective beginning with tax year 2010 for costs paid under binding contracts entered into after May 1, 2010, both individual income and corporate franchise taxpayers plus insurance gross premium taxpayers would receive a refundable tax credit equal to 100% of the federal historic structure rehabilitation tax credit. The federal credit allows taxpayers to claim a tax credit equal to 20% of the cost to rehabilitate a historic building. The tax credit can be transferred to any income tax or gross premium taxpayer.

To qualify for the credit, the rehabilitation costs must exceed 100% of the property's basis before rehabilitation. Federal law permits the tax credit to be taken only on income producing property.

In a process similar to the one used by taxpayers now receiving the federal tax credit, the State Historic Preservation Office of the Minnesota Historical Society would issue a part 3 certification on work eligible for the tax credit.

Also, taxpayers would be able to either qualify for a grant in lieu of the credit or to qualify for a combination of tax credit and a grant. The size of the grant cannot exceed 90% of the value of the federal credit. During fiscal years 2011-2015, the bill limits the total amount of credits and grants to $8,100,000 per fiscal year.

EXPLANATION OF THE BILL (Cont.)

Eliminate Dividend Received Deduction for REIT Dividends
As a general rule a corporation is allowed to take a dividend received deduction on dividends it receives from another corporation. There are exceptions to this general rule. For example, under both federal and state law a corporation that receives dividends from a regulated investment company cannot take the dividend received deduction.

Minnesota differs from federal law on whether dividends from a real estate investment trust (REIT) are eligible for the dividend received deduction. Under federal law a corporation that receives REIT dividends cannot take the dividend received deduction. Minnesota law contains no prohibition from using the dividend received deduction for REIT dividends.

Under both federal and state law, the taxable income of a REIT is computed in the same manner. Provided that a corporation distributes 90% of its income, its taxable income is computed using a dividend paid deduction. In most cases the dividend paid deduction reduces the taxable income of a REIT to zero.

Effective beginning with tax year 2010, the bill would disallow the dividend received deduction for REIT dividends.

Create Automotive Recovery Zone (CARZ)
The bill extends the tax benefits for businesses operating in a Job Opportunity Building Zone (JOBZ) to a business operating in a Create Automotive Recovery Zone (CARZ). The CARZ may be in the seven-county metropolitan area. The exemptions include corporate franchise tax, individual income, sales and use, motor vehicle sales, and some property taxes for a maximum of 12 years. Instead of the jobs credit under the JOBZ program, a separate refundable credit is allowed equal to $2,500 for each full-time equivalent employee plus an additional credit of $1,000 for full-time equivalent employees exceeding 750.

The bill provides for one CARZ. The Commissioner of the Department of Employment and Economic Development (DEED) may accept applications to designate a CARZ as soon as January 1, 2012, and any time prior to January 1, 2016. The zone is to be designated by the commissioner in an area that currently contains a motor vehicle assembly facility. The bill further limits the zone to a business that is located in a city of the first class and a facility with at least 500 employees that is used to assemble motor vehicles at the zone location. It is expected that the 12 year period of the zone would be from July 1, 2013 to June 30, 2025

Income Tax Personal Exemption Phase-out and Itemized Deduction Limitation
Current law eliminates completely the phase-out of personal and dependent exemptions and the limitation of several itemized deductions for higher income taxpayers in tax year 2010. Beginning with tax year 2011, current law restores the phase-out and limitation in full. The proposal is to accelerate that restoration to tax year 2010.

REVENUE ANALYSIS DETAIL

Small Business Investment Tax Credit

- It is assumed that maximum amount of tax credits for tax year 2010, $4.5 million and the maximum amount of tax credits of $9 million per year in tax years 2011-2014 would be claimed.
- It is assumed that all of the credit associated with investment made in tax year 2010 would be claimed in fiscal year 2011. Other tax years are allocated 50/50 to fiscal years. The total revenue loss for all years would be $40.5 million.

Historic Structure Rehabilitation Credit

- The estimate uses Department of Treasury tax expenditure estimates labeled tax incentives for preservation of historic structures in the Fiscal Year 2011 budget, Analytical Perspectives, Chapter 16: Tax Expenditures. Estimates made by the Joint Committee on Taxation are very similar to those made by the Department of Treasury.
- Minnesota's portion of federal estimates is based on Minnesota's portion of the U.S. tax credit for historic rehabilitation expenditures.
- In order to account for the effective date of binding contracts effective after May 1, 2010, the revenue estimate for the first year is reduced by 60%.
- After the first year, the limitation of $8.1 million would apply.

Eliminate Dividend Received Deduction for REIT Dividends

- The revenue impact is based on an analysis of statistics from the IRS on the amount of dividends earned by corporations. REIT dividends are reported as other dividends on Form 1120, Schedule C. The difference between total dividend income and the sum of dividends reported by various categories represents an estimate of the other dividend income.
- It is assumed that most of the other dividend income is dividends from REITs and Regulated Investment Companies (RICs). IRS statistics indicate that about 25% of the combined income from RICs and REITs is earned by REITs. As such, it is assumed that 25% of the estimated other dividends income is earned by REITs.
- The nationwide total of REIT dividends received by corporations was apportioned to Minnesota.
- The dividend received deduction is 80% of the total dividends received by corporations.
- The revenue gain from the proposal was reduced by 10% to reflect that corporations with an overall loss do not fully benefit from the dividend received deduction.

CARZ – Corporate Franchise Tax Exemption

- The estimated revenue loss from the corporate tax provisions in the bill is based on the assumption of a retooled auto plant that would begin operations in calendar year 2013.
- The loss of corporation tax revenue from exempting income earned in the zone is based on revised estimates made by the Department of Employment and Economic Development. The potential revenue loss ranges from $20 to $40 million over the life of the zone. As proposed to be amended, the designation of the zone is not in effect until July 1, 2013.

REVENUE ANALYSIS DETAIL (Cont.)

CARZ – Sales and Use Tax Exemption

- The expansion/retrofitting would begin July 1, 2013 to be eligible for the sales and use tax construction exemption (it has been reported that the qualifying plant would be available after December 2011).
- Based on information provided by the Department of Employment and Economic Development, it is assumed that $50 million of the expansion/retrofitting purchases would not be exempt under current law. It is estimated that 45% of these purchases would normally be subject to sales tax under current law.
- It is expected that the purchases related to the expansion/retrofitting would all occur in fiscal year 2014. This would cause a fiscal impact of $1.5 million in fiscal year 2014.
- For subsequent years, purchases for the facility would be exempt from the sales and use tax. It is estimated that the average annual fiscal impact of this exemption would be $65,000 annually.
- The total state revenue loss from exempting sales and use tax for the business in the zone is expected to be over $2,300,000 over the 12 year period.
- Any local sales tax that was previously applied in the zone would also be impacted.
- Currently the motor vehicle sales tax exemption accounts for about 1% of all JOBZ benefits. It is assumed that the impact of the motor vehicle exemption as a part of the CARZ benefits would be minimal.

CARZ – Jobs Credit

- The credit is $2,500 for each full-time equivalent employee. An additional credit of $1,000 is given for full-time equivalent employees exceeding 750. Based on information from the Department of Employment and Economic Development, the plant is expected to employ 750 workers in the first year and 800 in subsequent years.
- The jobs tax credit is estimated to be $1.9 million in calendar year 2014. The revenue loss in fiscal year 2014 is estimated to be 50% of the calendar year 2014 revenue loss. The jobs tax credit is estimated to be $2.0 million in fiscal year 2015 and beyond.
- The total cost of the jobs tax credit for all years is estimated to be over $22 million.

CARZ – Property Tax Exemption

- Based on a zone designation of July 1, 2013, the first assessment year eligible for a property tax exemption would be 2013.
- Beginning with taxes payable in 2014, the exemption from the state property tax would shift property taxes away from the qualifying business to other property taxpayers throughout the state. The total revenue from the state property tax would not be affected.
- Beginning with property taxes payable in 2014, the exemption would shift local property tax away from the qualifying business located in the zone and onto all other property, including homesteads.
- The increased property tax burden on homesteads caused by the local property tax exemption would increase state-paid homeowner property tax refunds beginning in FY 2015.

REVENUE ANALYSIS DETAIL (Cont.)

Income Tax Personal Exemption Phase-out and Itemized Deduction Limitation

- The House Income Tax Simulation Model (HITS 5.8) was used to estimate the revenue impact. These simulations assume the same economic conditions used by the Minnesota Department of Management and Budget for the forecast published in February 2010. The model uses a stratified random sample of tax year 2007 individual income tax returns compiled by the Minnesota Department of Revenue. The HITS model extrapolates these data for the applicable tax years according to the economic assumptions of Minnesota Management and Budget.
- Tax year impacts were allocated to the following fiscal year.
- Restoring only the exemption phase-out would affect about 62,000 returns in 2010, while restoring only the itemized deduction limitation would affect about 105,000 returns. If both were restored simultaneously about 113,000 returns would be affected.

Source: Minnesota Department of Revenue
Tax Research Division and
Property Tax Division, Research Unit
http://www.taxes.state.mn.us/taxes/legal_policy

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