May 2, 2019

The Honorable Paul Marquart
Chair, House Tax Committee
597 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

The Honorable Roger Chamberlain
Chair, Senate Taxes Committee
3225 Minnesota Senate Building
95 University Ave. W.
St. Paul, Minnesota 55155

Dear Chairs Marquart and Chamberlain:

As the conference committee on HF2125 begins, I look forward to working with you as the conference committee builds a tax bill that will benefit all Minnesotans. The tax bill is, of course, a fundamental part of the state's two-year budget. It represents the opportunity to provide needed investments to improve the lives of all Minnesotans while maintaining fiscal stability for the state's future. And, within the bill itself, there is an opportunity to prioritize income and property tax relief to working families, farmers, and seniors. The conference committee goal is to resolve the differences across the bills in a way that will improve the lives of Minnesotans – particularly those who have not yet had opportunities for economic prosperity – and can win the support needed for enactment. I am confident this can be done.

When Governor Walz and Lt. Governor Flanagan proposed their budget in February they prioritized investment in three areas: Education, Health Care, and Community Prosperity. These three priorities represent the foundations for success that all families across the state deserve.

In addition, their budget includes a tax bill that provides relief to working families across the state with an expansion of the Working Family Credit. It also makes critical investments in Local Government Aid and County Program Aid to support essential services to Minnesotans across the state while providing property tax relief. Their tax bill also provides tax relief to farmers with the buffer tax credit and valuable tax savings for equipment purchases. Their budget makes hard choices to invest in the people of Minnesota while maintaining fiscal stability.

There are many areas where the Governor's proposal and the House and Senate omnibus tax bills agree, including full conformity on Section 179 depreciation and raising at least $800 million in revenue from domestic business conformity with the 2017 federal tax law. There are, however, a number of areas where the proposals do not align. These include how revenue should be raised, how to conform to the foreign income taxed at the federal level, and to whom tax cuts are provided.

We are committed to ensuring the committee and the public have information about the Governor and Lt. Governor's proposals, the importance of responding to the federal law changes in 2017 and 2018, and the department's technical and administrative perspective to ensure implementation as intended. To that end, this letter is intended to provide information about provisions in the House and Senate versions of HF2125. We look forward to the work of the conference committee in the coming days and weeks.

Tax Relief for Working Families, Individuals, and Seniors
The conference committee has the opportunity to provide vital support to working families and individuals who were left behind by the federal tax reform of 2017. These Minnesotans are struggling to make ends meet in the face of the rising costs of quality child care, housing, and prescription drugs.

The Working Family Credit, Minnesota's corollary to the Earned Income Tax Credit, is a vitally important tool to fight poverty across Minnesota. About 12% of Minnesotans in greater Minnesota and the metro area use the credit to help sustain their families' budgets. Investing in these children and parents through the Working Family Credit will help create prosperity for all communities in our state. The Working Family Credit also helps build a fairer tax system because it offsets a portion of the state and local taxes, such as sales taxes, that lower-income people pay.

Although taking a slightly different approach than the Governor and Lt. Governor's proposal, we appreciate the House's significant expansion of the Working Family Credit.

The House position also expands the credit by increasing the rate and thresholds for households in all income tiers – families without dependent children, families with one child, and families with two children. These changes increase both the maximum amount of the credit available and the number of returns that qualify for the credit.

The Governor and Lt. Governor's proposal takes a slightly different approach but also invests $100 million in the Working Family Credit, with an expansion for larger families, an additional $200 for joint filers, and $100 for all other filers.

Similar to the Governor and Lt. Governor's budget, the House and Senate positions provide tax relief to seniors by increasing the maximum Social Security subtraction. The changes in the administration's budget provide tax relief to over 200,000 returns. Nearly 56% of Minnesota seniors would pay no tax on their Social Security benefits under this proposal.

The Senate bill unfortunately provides little income tax relief for low and moderate income Minnesotans. The Senate bill does not provide any additional funding for the Working Family Credit. While the bill includes a second tier rate reduction, not all Minnesotans will benefit from the cut. Families earning less than approximately $38,000 will see no tax relief from the rate reduction.

State Response to Conformity
We all agree on the importance of responding to the federal tax bill from 2017. Individual taxpayers, certified public accountants, and businesses have all expressed the need to address the changes.

We appreciate the common approach on moving Minnesota to Federal Adjusted Gross Income for individual income taxpayers and establishing Minnesota based dependent and personal exemptions. We also appreciate the common approach in providing businesses and farmers with full conformity to section 179 expensing and increased bonus depreciation while retaining the state's 80% add-back.

By moving Minnesota to the Federal Adjusted Gross Income, we are no longer tied to the priorities of Washington. Instead, maintaining itemized deductions for unreimbursed employee expenses and personal casualty losses that are no longer available at the federal level will provide valuable benefits to thousands of Minnesotans. Each bill also preserves much of Minnesota's current tax code for individuals, such as the Dependent Exemption, and provides significant benefits.

In addition, like the Governor and Lt. Governor's proposal, the House and Senate positions conform to the base-broadening provisions of the federal law change for domestic business income. The conformity in each of the proposals raises over $800 million through those base broadeners. As the committee knows, at the federal level, businesses were afforded a significant tax cut and these changes in Minnesota will not offset that significant reduction in federal tax.

This shared approach to conformity provides simpler tax filing and long-term record keeping for businesses by conforming to the federal law changes for domestic business income. For example, the bill limits net interest deduction to 30% of income for businesses. Any disallowed amount of deduction is allowed as a carryforward. This base expansion does not apply to businesses with gross receipts under $25 million. The bills also limit business losses in excess of $500,000 (married filing jointly). Businesses with losses over $500,000 can use the excess amount as a net operating loss in future years.

However, the Senate bill shields multinational corporations with foreign subsidiaries rather than prioritizing Minnesota families. It provides a 100% subtraction for Global Intangible Low Tax Income (GILTI), and the one-time deemed repatriation of deferred foreign income of individuals and corporations. The introduction of GILTI at the federal level was designed to curb the erosion of the U.S. tax base by multinational corporations. For C corporations, the GILTI provisions operate as a minimum tax that is intended to make sure U.S. corporations and their foreign subsidiaries pay corporate tax.

We are intently focused not only the specific changes at the federal level, but also on ensuring that we can help taxpayers smoothly transition to the new tax law. That requires specific concern for tax year 2018. We are still studying the impact of the effective dates in the bills and want to ensure we can make the tax system work for filers as we move forward.

Community Prosperity: Investing in Local Governments

Local Government Aid (LGA) and County Program Aid (CPA) provide vital investments in the services our local governments provide to Minnesotans. The Governor and Lt. Governor's bill and the House's bill propose a historic increase in investments to LGA and CPA, by $30 million per year, returning them to 2002 and 2000 levels. These are critical programs that help our cities and counties provide needed investments while providing property tax relief. We will continue to express the needs of our local government partners as this bill moves forward.

As we move forward, we hope to continue to discuss the inclusion of Governor and Lt. Governor's proposal to modify the sales tax exemption for local governments and nonprofits on the purchase of construction materials. This provision would allow nonprofits to invest more money into their mission and local governments would save money and be able to invest in the needs of their community while providing property tax relief for their residents.

Governor Walz and Lt. Governor Flanagan recommended levy authority for Soil and Water Conservation Districts (SWCD) in their budget. Our SWCDs play a vital role in the state's conservation delivery system. SWCDs are a special unit of local government, with elected officials. However, they do not have their own revenue-generating mechanism in this bill.

The Senate bill contains a couple of concerning provisions related to local governments. First, Article 6 of the bill prohibits locally elected officials from making decisions on behalf of their constituents, by prohibiting any governmental unit from applying fees on food containers and drinking straws.
This takes away a potential tool for cities and local governments to manage solid waste in their communities, which as noted the Legislature and state law requires them to handle. Additionally, the Senate position makes changes to Indian Child Welfare Act (ICWA) aid. We want to ensure all impacted persons and governments have an opportunity to weigh in and ensure the costs for Department of Human Services (DHS) along with counties are addressed. It is also important to ensure resources for training and child welfare. We will continue to work with you, DHS, and stakeholders moving forward.

Tax Relief for Farmers
As you know, this is a critical time for Minnesota's farmers. The most recent report from the University of Minnesota Extension and Minnesota State University found that farm income is 8% lower this year than last year, and is at the lowest it has been in 23 years.

We appreciate that the House and Senate bills include the administration's budget priorities to provide significant tax relief to farmers by conforming to the increased limits for section 179 expensing. This provision allows farmers and small businesses to expense up to $1 million of qualifying machinery, equipment, computer software purchases in the first year that the property is placed into service, and increases the phase-out threshold to $2.5 million.

The Governor and Lt. Governor's budget recommended a property tax credit for buffers to provide property tax relief for farmers. Under their proposal, landowners can claim an annual property tax credit of $50 per acre of eligible class 2a land maintained as riparian buffer or alternative riparian water quality practice.

The House took a different approach to providing property tax relief to farmers. The House position increased the agricultural school building bond credit. Increasing the credit from 40% to 70% will provide relief to farmers, while also making sure rural schools have the resources they need. The Senate's bill, however, does not provide any meaningful or broad property tax relief for Minnesota's farmers. Moving forward we committed to working with the conference committee to provide farmers with property tax relief.

Property Tax Relief for Homeowners, Renters, and Seniors
Governor Walz and Lt. Governor Flanagan included two additional recommendations for property tax relief that are not in HF2125 yet. The first allows taxpayers with an individual taxpayer identification number (ITIN) number to qualify for homestead status. Homestead status conveys several benefits to homeowners, including lower tax rates and qualification for the property tax refund. The second recommendation expands the senior citizen property tax deferral

program to help more seniors pay their property taxes. The changes to the program expand eligibility by decreasing the requirement to own or occupy the home from 15 to 5 years, and moves the application deadline from July 1 to November 1 to increase access to the program.

While it was not included in the Governor and Lt. Governor's budget, we appreciate the House's position to increase the homestead and renter credit program. This program is an important tool to provide property tax relief to families across the state. Each year about 800,000 Minnesotans receive the property tax refund to help offset their property taxes. The House's changes will provide over $40 million dollars in relief for property taxes payable in 2020. Minnesotans who receive this property tax refund use it to buy essentials for their family and catch up on bills. This spending in turn boosts our local economies.

Business Tax Relief and Simplicity

<u>Section 179 Expensing</u>

The Governor and Lt. Governor's budget, and the House and Senate bills, provide significant tax relief to small businesses by conforming to increased limits for section 179 expensing. This provision allows businesses to expense up to $1 million of qualifying machinery, equipment, and computer software purchases in the first year that property is placed in service and increases the phase-out threshold to $2.5 million.

The proposal will also allow certain improvements to nonresidential real property, such as roofs and heating and cooling systems, to be expensed. The budget and tax bills fully conform to the federal changes by eliminating the current Minnesota 80% add-back modification. The Governor and Lt. Governor's budget, as revised, and the Senate bill maintain significant tax relief by conforming to the scope of changes in 2018 and removing the add-back beginning in 2019. The House bill removes the add-back beginning in 2018. We appreciate this full conformity approach.

<u>Bonus Depreciation</u>

The Walz-Flanagan proposal and House and Senate bills also conform to the bonus depreciation deduction while maintaining the Minnesota 80% add-back modification. Bonus depreciation for equipment, computer software, and certain improvements to nonresidential real property allows an immediate deduction rather than depreciation over time. Both of these deductions provide important acceleration of deductions for business operational plants, equipment, and other assets placed into service. The deductions can stimulate business investment by reducing the cost of capital and increasing cash flow.

<u>Corporate AMT</u>

The Governor and Lt. Governor's bill recommends a repeal of the corporate Alternative Minimum Tax (AMT) as was done in the federal law change. This change reduces complexity for businesses. Requiring a Minnesota AMT will require tax preparers and taxpayers to continue significant bookkeeping relating to an obsolete federal law and calculations for Minnesota purposes. The repeal of the corporate AMT is appropriately paired with conformity to limit net operating losses to 80% of taxable net income in order to ensure that corporations pay some amount of tax each year.

Angel Tax Credit

The House and Senate bills contain the Governor and Lt. Governor's extension of the Angel Tax Credit. The Angel Tax Credit provides incentive for investors or investment funds to put money into early stage companies focused on high technology and new proprietary technology. The program has issued over $100 million in credits to investors to spur economic growth. We encourage the conference committee to support the credit extension for two years, $10 million per year, as recommended by the Governor and Lt. Governor.

Federal Partnership Audit Response

The Department's policy and technical bill and the House bill include an approach to respond to the federal changes in the partnership audits that maintain consistent calculation of tax for resident partners. We have concerns with the federal partnership audit provision included in the Senate bill as it changes the tax calculation of certain resident partners in tiered partnerships and increases the opportunity for complex partnerships to make organizational changes to avoid taxation. The bill also makes changes to the state statute of limitations and return adjustments following federal audit for all taxpayers, not just partnerships. We appreciate the opportunity to continue the discussion on implementing this provision and its proposed changes to tax calculation, rules for reporting changes, and related adjustments to returns.

Sales Tax Fairness

The Governor and Lt. Governor's bill included a number of provisions important to ensure fairness for brick-and-mortar retailers and purchasers of software.

Wayfair

The Supreme Court's decision in *Wayfair v. South Dakota* was about ensuring fairness for retail sales, whether they are made at a storefront in Minnesota or through a remote seller. The decision caused two existing Minnesota laws to become effective for remote sellers and marketplace providers.

The changes in the House bill and the Governor and Lt. Governor's bill are needed to ensure consistency, ease current requirements on sellers, and continue to pursue a level of uniformity among the states– a tenet of the *Wayfair* decision.

Qualified Data Centers

The House bill, like the Governor and Lt. Governor's proposal, includes provisions to narrow the application of the sales tax exemption for Qualified Data Centers. This change limits the amount of software purchases eligible for the refund from 100% to 50%, and shortens the timeframe for the exemption from 20 years to 5 years.

Other Concerning Provisions

Education-Related Provisions

The Senate bill conforms to the federal treatment of section 529 savings plans to include tax benefits for K-12 private school tuition. The Governor and Lt. Governor have expressed concerns about extending public money to private schools, but this bill provides additional ways for state government to reimburse individuals for private school tuition. The Governor and Lt. Governor oppose this provision.

There are a number of concerns with the scholarship foundation credits in Article 2 of the Senate bill that provide tax benefits to those with higher incomes, specifically those who can afford to make donations to foundations that provide scholarships to private schools. These tax credits are different from any other credit in our tax code and provide taxpayer money to fund non-public schools. The donations to the qualifying entity will provide the taxpayer with a state credit as well as a federal charitable deduction.

Another concern with this credit is that it has very little accountability to measure whether or not it is effective at actually creating positive outcomes. With public schools we know the schools are following state and federal accountability requirements. We acknowledge that an amendment was added on the Senate floor to provide additional accountability for students with disabilities. Private schools are not subject to standards of accountability so there is not a good way to measure how well the students who would potentially receive scholarships as a result of this tax credit would perform compared to their public school counterparts.

The Senate provision also establishes a credit for donations to public school foundations to fund student transportation needs. While this is an admirable need to fund, the solution is to directly fund public school so that they can provide full services to students. It is also concerning that the bill places a new requirement on public schools that 30% of their student population be receiving free or reduced priced student lunch. No similar requirement is imposed on private schools.

This school tuition credit proposal would spend over $100 million over the budget window. This is a significant tax benefit giving preferential treatment to certain charitable causes in Minnesota over other equally as worthy causes, while diverting public money to private schools. Because this bill provide public resources to finance private K-12 education, the Governor and Lt. Governor oppose this provision.

<u>Private Letter Rulings and Other Administrative Concerns</u>

Article 9 of the Senate bill contains several significant changes to how we administer the tax system in Minnesota. As we have explained in our fiscal note, these changes will require a significant amount of additional personnel – approximately 93 FTEs at a cost of about $27 million. Aside from the administrative costs, this will have negative impacts for taxpayers.

Private Letter Rulings. The private letter ruling program provides specialized guidance only for those who can afford it. The costs of issuing such letters will be well beyond the statutory fee to the state.

This provision is modeled after a federal program, and many states do have a guidance program. Few states have programs in place as robust as the federal program and they charge up to $10,000 for a private ruling. Others have less formal programs and limit the issues they will cover.

Minnesota already has many ways to provide guidance to taxpayers. Other state's private letter ruling programs address the many questions that are asked about alternative apportionment for corporate income tax. Minnesota law already provides a program – under Minnesota Statutes, section 290.20 – to receive petitions for alternative apportionment that taxpayers can rely on into the future.

Minnesota also has its own public ruling program, which are known as Revenue Notices. This program is not entirely different from programs in other states. But unlike private letter rulings, a published Revenue Notice can provide guidance on complex questions that can be relied on by everyone– regardless of ability to pay – and anyone can ask the Department to develop a Revenue Notice on a particular topic.

Limitation on Assessment. Article 9 of the Senate bill also limits the ability of the department to make sales, income, and corporate tax assessments that are inconsistent with prior written positions – including an audit report that does not address the issue. This provision would have negative impacts on our customers – we would stop a number of practices that currently benefit our customers.

The provision will prevent the department from adjusting any returns during processing. Instead, any item identified as needing adjustment during return processing - such as math errors - would need to be fully reviewed at that time to ensure that we are not missing an issue that may come up later. This will delay by years the ability of the department to make appropriate adjustments during return processing.

The provision will also chill the department's efforts to answers questions by email. Today, we focus on providing reliable information in the least expensive manner, with the quickest turnaround possible. For example, we responded to over 40,282 emails in our Sales and Use Tax, Withholding, and Income Tax divisions. Our current turnaround for these emails is 2-3 business days. If we continued answering questions by email as we do now – and this bill were law – we would not be able to provide this information, because we would need to be sure we had all of the facts and details before providing an answer that would bind the department going forward. We anticipate there could be litigation with customers over whether facts were fully disclosed in the email exchange.

The provision will significantly increase the length of audits, the number of auditors assigned to each audit, the number of auditors at a place of business, and the amount of time spent at a place of business to ensure that every audit was fully comprehensive.

Exemption for De Minimis Penalties. Article 9 of the Senate bill also exempts de minimis penalty amounts for failure to pay tax liability on time. Penalties are used as a way to assure that taxpayers are not intentionally ignoring due dates; it ensures that taxpayers are treated fairly.

The lack of any appropriation for these provision in Article 9 of the Senate bill does not recognize the scope of the impact and work that is required. We urge the committee to consider the impact on our customers from these changes, and the costs associated with these changes and the removal of these provisions.

<u>Lawful Gambling</u>
We also have concerns about the changes made to lawful gambling in the Senate's bill. First, the change to lawful gambling includes a $10 million rate cut for these gambling providers. We are still reviewing the amendment on the floor regarding the stadium reserve and the intent to hold the reserve harmless to fully understand its impact. In addition, we need to ensure all stakeholders have had an opportunity to understand and weigh in on the impacts of these provisions.

<u>Occupation Tax</u>
The Senate bill also makes changes to the occupation tax – this tax is in lieu of the corporate tax for mining companies. We have some concerns with the changes, and look forward to ensuring this tax treats mining companies fairly relative to other companies in the state.

State Assessed Property Valuation

Article 4, Section 17, of the Senate bill requests the department notify counties of preliminary values for state assessed properties by June 15. However, as we explained in testimony to committee, we do not receive all of the return information from companies until April 15. The state assesses the property of approximately 160 companies each year. The proposed deadline is too short to allow the department to complete these very important and complex valuations. While we understand that local governments need this information to determine their budget and levy amounts, accurate valuations are also a priority for the department and counties.

The Senate bill also added additional requirements for notification to counties when state assessed properties appeal their valuations in Article 4, Sections 18 and 19. The Department of Revenue met with stakeholders and is pilot testing an electronic notification with the counties. We remain committed to working with local jurisdiction to make sure all parties and taxpayers are best served.

Revenue Stability

The Governor and Lt. Governor are committed to long-term fiscal responsibility, which is why they recommended undoing three changes in the 2017 tax bill: the state general levy inflator, the cigarette inflator, and the $3 million estate tax exemption. These ongoing sources of revenue are needed to ensure we can make necessary investments in the items like the Working Family Credit, Local Government Aid, and County Program Aid.

The Governor and Lt. Governor's tax proposal reinstates the state general levy inflator beginning with taxes payable in 2020. Reinstating the inflator will improve our state's long-term economic well-being by allowing the state general levy to keep pace with the increased cost of public services. The House takes a different approach and freezes the portion paid at the current rate of 42.416%, which will also improve Minnesota's economic stability. However, the Senate goes in the opposite direction by lowering the corporate industrial levy by $47.5 million.

The House's and the Governor and Lt. Governor's bills both freeze the estate tax exemption at $2.7 million. Family farms and businesses will maintain their existing $5 million exemption when they pass on their farms or businesses to their heirs. The estate tax change passed by the legislature in 2017 resulted in over 700 of the wealthiest 1,000 estates in Minnesota no longer having a potential liability for the Minnesota estate tax. Freezing the estate tax exemption at its current level will reduce the regressivity of Minnesota's tax code.

We also commend the House for reinstating the inflator on tobacco taxes, and the Senate for including a new tax on vapor products. We know that price is one of the biggest deterrents of youth smoking, and vapor products have become especially popular among youth. The Governor and Lt. Governor's tax bill included the reinstatement of the inflator on tobacco taxes and increasing the premium cigar tax increases that were removed in 2017.

Closing

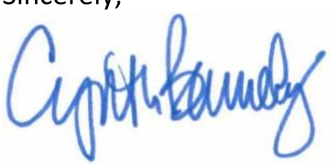
As the conference committee begins, the Department of Revenue would like to reaffirm our commitment to making sure policies included in the final tax bill can be administered well for the taxpayers you intend to benefit with these policy choices. We will continue to share policy and administrative concerns as the conference committee works.

We also thank the House and Senate for including many provisions from the department's policy and technical bill, including moving to more inclusive language for our tax code, updating certifications, clarifying definitions, and providing clear guidance for taxpayers and tax administrators. These technical updates allow for Minnesota's tax code to be administered efficiently and effectively.

In addition, we will provide further information about the costs to administer the changes in the bill. As indicated previously, Article 9 in Senate bill will cost more than $27 million per biennium. In addition there are costs to ensure that the department can make changes to our tax system to accommodate the changes to Minnesota law in response to the federal bill. While we have not yet completed analysis of the administrative costs of the full House and Senate provisions in conference, we would estimate that the cost could be in the $6-8 million range for the first year with lower ongoing costs each fiscal year thereafter. You may be aware that the Senate State Government Finance bill cut $35 million from the department's needed budget to simply maintain existing services. That reduction alone is untenable. We need that funding restored, and the resources to perform the additional significant work in this bill, if taxpayers are to be well served and have a filing system that works for them.

Thank you for your work over the past several months and for the assistance of your staff. As the conference committee moves forward, we will continue to press for tax relief for low and middle income Minnesotans, and property tax relief for farmers, while also ensuring the revenue needed to make investments in housing, healthcare, education, and other essential services across Minnesota with Local Government Aid and County Program Aid.

Sincerely,



Cynthia Bauerly
Commissioner