



2002 Special Session
Fiscal Summary of
Flood Relief
& Tax Provisions

Money Matters 02-08
October 2002

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Chapter 1: Flood Relief Package

The Legislature met in Special Session on September 19, 2002 and approved an emergency flood relief package (2002 Laws, First Special Session, Chapter 1) for the flood victims and local governments in the 19 counties named in Presidential Disaster Declaration DR-1419. The 19 counties include: Becker, Beltrami, Clay, Clearwater, Goodhue, Hubbard, Itasca, Kittson, Koochiching, Lake of the Woods, Mahnommen, Marshall, McLeod, Norman, Pennington, Polk, Red Lake, Roseau, and Wright.

The package contained \$31.78 million for flood relief. The appropriations for the major categories of relief are shown in Table 1 below. Table 1 also shows the sources of funding used to pay for the for the relief package.

Package Item	Appropriated Amount (\$ in thousands)	Funding Source (\$ in thousands)				
		General	G.O. Bonding	Trunk Hwy	T.H. Bonding	Petro
Federal Emergency Funds Match (1)	8,300		8,300			
Property Tax Relief: Abatement Aid	1,000	1,000				
Business Assistance	3,000	3,000				
Public Infrastructure Assistance	2,000		2,000			
Fuel Contaminated Property Assistance	1,000					1,000
Housing Assistance	4,000	3,000	1,000			
Agriculture Relief	3,000	3,000				
Local Roads & Bridge Assistance	5,000		5,000			
Roseau Schools Flood Enrollment Impact (FY'03)	40	40				
Roseau Schools Flood Enrollment Impact (Tails)	60	60				
Bond Sale Expenses (2)	30		15		15	
State Road and Bridges	2,000			2,000		
Transportation Cancellation & Replacement	0	(10,100)			10,100	
Net New Appropriations	29,430	0	16,315	2,000	10,115	1,000
Property Tax: Flood Replacement Aid	350	350				
Flood Prevention/Control	2,000		2,000			
Reallocated Current Funds	2,350	350	2,000	0	0	0
Grand Total:	31,780	350	18,315	2,000	10,115	1,000

(1) Additional money to match FEMA will be from the existing appropriation in the Dept. of Public Safety. The estimated appropriation balance is \$1.4 million, of which, \$1.37 million is projected to be used for DR-1419.

(2) The bill has debt service costs to the General and Trunk Highway Funds. The General Fund costs are estimated at \$297,000 in FY 2003; \$1.016 million in FY 2004; and \$1.421 million in FY 2005. The estimated debt service costs to the Trunk Highway Fund are not available.

(3) Section 13 of the bill relating to Group Residential Housing Assistance rates is estimated to have a General Fund cost of \$25,500 in FY 2003 and \$51,000 each year in FY 2004-05.

Note: If general fund appropriations in Chapter 1 for any program are not needed for that program, the unexpended amounts are available for other programs in the flood relief package or for the match required by the Federal Emergency Management Agency for its programs.

Federal Emergency Funds Match

\$8.3 million in bond funds is appropriated to the Department of Public Safety to fully pay for the state and local match of federal disaster assistance funds. In past disasters the state is normally responsible for 15 percent of the non-federal share and local units of government are responsible for 10 percent. Eligible costs are for the repair, restoration, or rebuilding of the public infrastructure that has been damaged or destroyed during the disaster. The funding can be used for roads and bridges, water control facilities, buildings and equipment, utilities, and parks and recreational facilities.

Business Assistance

\$3 million is appropriated from the general fund to the Minnesota Investment Fund for grants to local units of government. The funds will support locally administered grants and/or loan programs to businesses that were directly and adversely affected by the flood. The appropriation language is designed to provide maximum flexibility to accommodate the recovery needs of businesses.

Public Infrastructure

\$2 million in bond funds is appropriated to the Public Facilities Authority for grants to local units of government to assist with the cost of rehabilitating and replacing publicly owned infrastructure. The infrastructure includes storm sewers, wastewater and municipal utility service, and drinking water systems. Grantees are exempted from the regular criteria, limitations, and repayment requirements of the PFA's financing programs.

Petroleum Contamination

Up to \$1 million is appropriated from the Petrofund to provide grants for rehabilitating buildings that were damaged by petroleum contamination. The grants are limited to only the extent that the damage is directly attributable to petroleum contamination. The funds may also be used to buy out properties substantially damaged by a petroleum tank release.

Housing Assistance

\$3 million is appropriated from the general fund to the Economic Development and Housing Challenge Program for a wide variety of housing assistance activities. The activities include refinancing, interest rate reduction, permanent financing, construction financing, new construction, acquisition, gap financing and rehabilitation. The Program's match funding requirements are waived.

\$1 million is appropriated from bond funds for publicly owned permanently rental housing. A similar appropriation was included in the 1997 flood relief bill and was found to be particularly useful for developing senior housing.

Agriculture

\$3 million is appropriated to make payments of up to \$4 per acre to farmers with crop loss of 50 percent or more. To be eligible, a farm must have at least 40 acres. A farmer may not claim payments on more than 1,400 acres. Farmers must apply to the Commissioner of Agriculture by December 13. By January 15, the commissioner must determine the payment amount (dividing the \$3 million by total eligible acres not to exceed \$4 per acre) and by January 31, the commissioner must make payments to farmers.

Human Services

An exception is provided to the group residential housing (GRH) supplemental room and board rate for up to 20 individuals in up to five corporate adult foster care facilities in Roseau County that are established to replace an intermediate care facility (ICF/MR) in Roseau that became uninhabitable because of flood damage. The current limit is the county average in effect on January 1, 2000, the exception allows a rate up to \$426.37. This provision is estimated to have a net cost of \$25,500 in FY 2003 and \$51,000 per year in FY 2004 and after.

K-12 Education

The act creates a declining pupil aid for four years beginning in FY 2003, with the aid calculated as the lesser of the actual decline in the number of pupils for that year compared with the 2001-02 school year times the formula allowance for that year times a phase out factor, or a maximum dollar amount. The phase-out factor is one for FY 2003, and goes down by 25 percent for each subsequent year. The maximum is \$40,000 for FY 2003 and decreases by \$10,000 for each subsequent year. If the district's enrollment does not actually decrease, then no aid will be paid to the district.

Transportation

Chapter 1 included \$7 million in new spending for transportation related repair and replacement. Of this amount, \$5 million in general obligation bonds are authorized for repair of local roads and bridges. The other \$2 million is appropriated from the trunk highway fund for repair of state highways on the trunk highway system.

To offset the new general fund spending in the Flood Relief package, the "one-time" general fund appropriation in Laws of 2000 chapter 479 for highway construction is reduced by \$10.1 million and canceled to the general fund. The cancellation of these dollars from the highway construction appropriation represents a net loss to road projects. In order to keep construction projects on schedule, \$10.1 million in trunk highway bond are authorized, in effect replacing general fund cash for highway construction with borrowing against the future revenues of the trunk highway fund. The cost of this action will be a loss of roughly \$15 million from the trunk highway fund, spread over twenty years.

Environment

The Department of Natural Resources identified a need for \$2 million in emergency flood control projects in the disaster relief area. These emergency projects differ from the extensive, long term flood mitigation projects typically funded by the program. They will concentrate on small emergency projects such as additional pump stations or small levies and berms to aid if

flood waters return, but not true long term solutions to flood mitigation, which will be dealt with in the coming years.

The 2002 Capital Investment bill appropriated \$30 million for flood mitigation projects throughout the state. Of this amount, the Governor put “on hold” \$15 million in order to reduce the size of the bill until the state’s deficit problem was corrected. The agreement reached between the Governor and Legislature was to free up at least \$2 million of the dollars on hold for use in the affected disaster area. It is unclear if the Governor will free up additional money from the portion still on hold, and release any of the remaining \$13 million to fund projects originally specified in the 2002 Capital Investment bill.

Capital Investment

Due to the small size of the flood package relative to the amount of state bonds outstanding (\$3 billion as of November 1, 2002), the flood relief bill will have little impact on the state’s debt capacity for future legislative sessions. The passage of the bill increased general fund debt service required in the fiscal 2002-2003 biennium by \$297,000. The state’s AAA credit rating will remain unaffected by the flood relief bill. General Fund cost of \$25,500 in FY 2003 and \$51,000 each year in FY 2004-05.

Property Taxes

Chapter 1, 2002 First Special Session, contains six property tax relief and local government aid provisions designed to assist communities and property taxpayers with flood recovery efforts. Five provisions closely parallel assistance made available to victims of natural disasters in prior years and one, a tax increment financing provision, is a new form of assistance. Two provisions, the early state aid payment authority and expanded tax increment authority, were made general law and apply to the 2002 floods and future natural disasters.

Assistance to individuals include:

Abatement of 2002 property taxes - \$1.0 million was appropriated to reimburse counties for granting abatements to property owners in disaster counties. To qualify for an abatement, the property must have contained a structure and the structure must have lost 50 percent or more of its market value due to the floods. The amount of the abatement is equal to 50 percent of pay 2002 taxes on that parcel. Preliminary estimates now indicate that the actual amount of abatements will be about \$275,000 but any funds not used for abatements may be reallocated to other flood assistance programs. Abatements do not include special assessments and property tax payers are not required to apply for the abatements. In addition to the \$1 million appropriation, state general fund revenues are expected to be \$61,000 lower than forecasted due to abatement of state general property tax.

Delayed payment for 2002 property taxes - Owners of commercial and industrial property (all class 3 property) who are unable to make their second-half property tax payment due to the floods may delay that payment without penalty until May 15, 2003. To qualify, a property owner must have made a first-half property tax payment on-time and apply to the county auditor. Local governments are not required to allow delayed payment for special assessments.

Value exclusions for commercial property - Small businesses that experienced damage due to the 2002 floods and then repaired or reconstructed their businesses will be allowed to exclude from taxation any increase in property value, up to \$50,000, relative to the pre-flood value. The value exclusion will last five years and then the value will be added back 20 percent per year over the following five years. To qualify, a business must be located in a disaster county, have suffered damage due to the 2002 floods, be located in a city under 10,000, have a pre-flood value of \$150,000 or less, seek a building permit or notify the assessor as required under general law prior to commencing the improvement, and must not be receiving an abatement under general law. Improvements must be made prior to January 1, 2004.

Assistance for local governments includes:

Early state aid payments - A permanent law change enacted by Chapter 1 directs the Commissioner of Revenue to pay second-half (December 26) local government aid payments as early as practical (but not before July 20) for local governments that have been determined by the Commissioner of Public Safety to have suffered financial hardship due to a natural disaster. Further, prior general law authorizing allowing for early LGA payments upon an application from the local government demonstrating cash flow need was expanded to also authorize the early payment of HACA, criminal justice aid, and family preservation aid upon a successful appeal to the Commissioner of Revenue for early payment. Both early payment provisions apply to homestead and agricultural credit aid (HACA), local government aid (LGA), family preservation aid, and criminal justice aid.

Flood loss replacement aid - In 2004, any city located in a disaster county that lost five percent or more of its tax capacity due to 2002 floods will receive additional state aid. The amount of additional aid will be equal to the loss in net tax capacity multiplied by the city's average city tax rate for 2003. The provision, which preliminary estimates indicate will direct about \$350,000 to flood cities, will have no state general fund cost because the funds will be taken from the forecasted growth in the LGA appropriation from 2003 to 2004.

Tax increment financing (TIF) - A permanent, general law change authorizes cities (TIF authorities) to reduce the original net tax capacity of an existing district, or to certify a lower net tax capacity for new district, to reflect the assessor's estimate of the effect of a natural disaster on the value of property located in a tax increment district. The authority applies only to cities located in disaster or emergency areas and the adjustment cannot reduce the original net tax capacity to below zero.

Other Tax Provisions (Non-Flood Related)

Two other acts were enacted in the 2002 Special Session. Both changed tax law in ways that were considered revenue neutral relative to the February 2002 forecast.

Chapter 2: Modify Charitable Contribution Deduction under the AMT.

Chapter 2 responds to the Minnesota Supreme Court decision in *Chapman v. Commissioner of Revenue*, which ruled that the tax treatment of charitable contributions in the Alternative Minimum Tax (AMT) was unconstitutional. The AMT (unlike the regular income tax) had allowed a deduction only for contributions given to a *Minnesota* charity. The court ruled that favoring Minnesota charities in this way discriminates against interstate commerce and violates the Commerce Clause of the U.S. Constitution.

The court's remedy was to disallow *all* deductions of charitable contributions under the AMT, regardless of the location of the charity. This court decision would have increased tax liability by roughly \$20 million per year. The number of taxpayers who paid AMT would have risen by about 50 percent.

Chapter 2 allows a deduction under the AMT for all contributions in excess of 1.3 percent of the taxpayer's adjusted gross income. The location of the charity no longer matters. The 1.3 percent threshold was selected to make the provision revenue neutral relative to the February forecast. For all taxpayers combined, the benefit of deducting all contributions above 1.3 percent of adjusted gross income equals that of the original deduction limited to Minnesota charities.

What is the Alternative Minimum Tax?

The AMT is an alternative to the individual income tax. Like the federal tax, it was enacted in response to reports of millionaires who paid no income tax because they had large deductions or most of their income was exempt from tax. The alternative tax is levied at a lower tax rate (6.4 percent), but on a much broader tax base. If AMT liability exceeds a regular income tax liability, the taxpayer pays the difference as their AMT payment. In 2002, approximately 25,000 taxpayers will pay a little over \$30 million in AMT.

Characteristics of AMT Taxpayers (2002)		
Comprehensive Income*	Number of Returns	Dollars of Tax
Less than \$100,000	40%	14%
\$100,000 – \$249,999	43%	25%
\$250,000 - \$499,999	13%	21%
\$500,000 and over	4%	40%
Total	100%	100%

*Income is defined to include all forms of income, including income not subject to regular income tax.

The court case raised AMT liability by about \$20 million per year above the February forecast. Chapter 2 reduced AMT liability back to what had been forecast in February.

The court case and law change affect only the individual AMT. There is no change in the charitable deduction rules for the regular income tax, nor are the rules changed for the corporate franchise tax and corporate AMT. Chapter 2 is effective beginning with the 2002 tax year; the court remanded the Chapman case back to the Tax Court to address earlier tax years.

Gainers and Losers from AMT Change: Compared to the law in effect before the *Chapman* ruling, some taxpayers are worse off, while some are better off. Deducting all contributions over 1.3 percent of adjusted gross income (new law) may be better than deducting all contributions to Minnesota charities (old law).

- Those giving 10 percent of their income to charities gain if less than 87 percent of their gifts go to Minnesota charities.
- Those giving 5 percent of their income gain if less than 74 percent of their gifts go to Minnesota charities.
- Those giving 2.5 percent of their income gain if less than 48 percent of their gifts go to non-Minnesota charities.
- Those giving 1.3 percent of their income – or less – can now claim no deduction, so they are worse off if *any* of their gifts go to Minnesota charities.

The number of losers exceeds the number of gainers by a ratio of 6 to 1 (and in every income class). The number paying AMT in 2002 rises by about 7 percent (1,600 taxpayers). The total tax paid by those with incomes over \$500,000 falls; all other income classes pay somewhat more in tax.

Chapter 3: Clarify Sales Tax for Delivery Charges

Chapter 3 clarifies the original intent of a law change enacted during the 2002 session. The intent of the 2002 law change was to provide equal tax treatment for delivery charges of aggregate material and concrete block, regardless of whether delivery was by the seller or by a third-party hauler. A provision adopted in 2001 made seller delivery charges taxable if the product itself were taxable, but third-party delivery charges remained non-taxable. To level the playing field, the 2002 provision made third-party delivery charges taxable as well.

The Department of Revenue planned to interpret the taxability of third-party delivery more broadly than intended. Contrary to legislative intent, third-party delivery charges would be taxable in some cases where seller delivery charges are not taxable (such as aggregate delivery to townships). Moreover, delivery charges by third-party haulers would be taxable even if no sale had been made (as when aggregate materials are moved from one construction site to another, with no change in ownership).

The clarification is retroactive to July 1, 2002 and includes explicit language for a six-month transition period for existing contracts (the same as past department practice for similar law changes).

The Department interpretation would have increased revenue significantly beyond what had been assumed in the revenue estimates for the 2002 Omnibus Tax Act. The clarification in Chapter 3 reduces tax revenue back to what had been assumed for the end-of-session revisions of the February forecast, so the changes were considered to have *no cost relative to the February forecast*.