HOUSE RESEARCH

Bill Summary

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Article 1: Individual Income and Corporate Franchise Taxes

Overview

Reduces the individual income tax rates to 4.75%, 6.75%, and 7.85%, phased in from tax year 2012 to tax year 2014.

Increases the research credit from 10 to 12.5 percent of the first $2 million of qualifying research and from 2.5 to 5 percent of the excess over $2 million.

Enacts a new Minnesota Science and Technology Program for the purpose of encouraging technology start-up businesses, funded with dedication of certain income tax withholding revenues of $7 million per biennium.

Allows an on-going deduction for contributions of food inventory by S corporations, partnerships, and sole proprietors under the same rules that apply to C corporations.

Authorizes a new income tax reciprocity benchmark study and directs the commissioner of revenue to enter into negotiations with the Wisconsin secretary of revenue, with the goal of restoring income tax reciprocity between the new states, with payment made from Wisconsin to Minnesota in the same fiscal year in which revenues are foregone.

Eliminates the commissioner's authority to terminate reciprocity agreements.

1 **Citation.** Names the law proposed in sections 2 through 10 the "Minnesota Science and Technology Program."

2 **Definitions.** Defines the following terms for purposes of the program:

Authority is the Minnesota Science and Technology Authority, an existing state entity that is established in Minnesota Statutes, section 116W.03.

Base-year taxation is tax year 2010 Minnesota income tax withholding, adjusted for inflation (based on the Minneapolis-St. Paul consumer price index), for science and technology employees working for primary science and technology companies.

College or university is a private or public postsecondary education institution that grants academic degrees and conducts research and development in science and technology.

Commercialization includes all of the activities involved with developing, producing, and selling a new product, ranging from doing the basic research at the "conceptual stage" through selling the product.

Commercialized research project is research conducted in a college or university or at a nonprofit research institution or by a qualified science and technology company that has shown advanced commercial potential in the form of licenses, patents, or similar and for which a qualified science and technology company is being or has been formed.

Fund is the Minnesota science and technology fund created under section 3.

Nonprofit research institution is a 501(c)(3) organization with its principal place of business in Minnesota that conducts significant research and development activities in Minnesota.

Primary science and technology company means a business in one of the following NAICS codes:

- Petroleum and Coal Products Manufacturing (3241)
- Basic Chemical Manufacturing (3251)

- Resin, Synthetic Rubber, and Artificial and Synthetic Fibers and Filaments Manufacturing (3252)
- Pesticide, Fertilizer, and Other Agricultural Chemical Manufacturing (3253)
- Pharmaceutical and Medicine Manufacturing (3254)
- Paint, Coating, and Adhesive Manufacturing (3255)
- Other Chemical Product and Preparation Manufacturing (3259)
- Agriculture, Construction, and Mining Machinery Manufacturing (3331)
- Industrial Machinery Manufacturing (3332)
- Commercial and Service Industry Machinery Manufacturing (3333)
- Engine, Turbine, and Power Transmission Equipment Manufacturing (3336)
- Other General Purpose Machinery Manufacturing (3339)
- Computer and Peripheral Equipment Manufacturing (3341)
- Communications Equipment Manufacturing (3342)
- Audio and Video Equipment Manufacturing (3343)
- Semiconductor and Other Electronic Component Manufacturing (3344)
- Navigational, Measuring, Electromedical, and Control Instruments Manufacturing (3345)
- Electrical Equipment Manufacturing (3353)
- Other Electrical Equipment and Component Manufacturing (3359)
- Aerospace Product and Parts Manufacturing (3364)
- Other Transportation Equipment Manufacturing (3369)
- Medical Equipment and Supplies Manufacturing (3391)
- Software Publishers (5112)
- Wireless Telecommunications Carriers (except Satellite) (5172)
- Data Processing, Hosting, and Related Services (5182)
- Computer Systems Design and Related Services (5415)
- Scientific Research and Development Services (5417)
- Engineering Services (541330)
- Testing Laboratories (541380)
- Environmental Consulting Services (541620)
- Other Scientific and Technical Consulting Services (541690)

Program is the Minnesota Science and Technology Program.

Qualified science and technology company is a business with fewer than 100 employees engaged in research, development, or production of science or technology in Minnesota.

Withholding taxes means the total amount of Minnesota state income taxes withheld from the wages of employees of primary science and technology companies during a calendar year.

3 **Minnesota Science and Technology Fund.** Establishes the Minnesota Science and Technology Fund as a special revenue fund in the state treasury. Payments from the fund may only be made at the request of the Authority. Each year the commissioner of revenue and the authority set the amount of the base-year taxation and determine the total increase in collections over that base-year amount. 85 percent of this increase, up to a maximum of $7 million per biennium, is dedicated to the fund. This dedication begins with calendar year 2011 withholding taxes. The commissioner of management and budget is authorized to make quarterly estimated payments with an annual reconciliation.

4 **Authorized uses of the fund.** Authorizes the fund to be used for:

- The commercialized research program under section 5
- The federal research and development support program under section 6
- The industry innovation and competitiveness program under section 7
- Carrying out the powers of the authority to award grants and loans under section 8

5 **Commercialized research program.** Authorizes the authority to establish a commercialized research program to encourage the creation of science and technology jobs. This program can provide grants of up to $250,000 per project for:

- Research projects to assist in the commercialization of science and technology, developed by a college, university, or nonprofit organization and transferred to a qualified science and technology company
- Projects developed directly by a qualified science and technology company

This program is subject to the following limits:

- The authority must establish written criteria for award and use of the grants
- The recipient (college, university, nonprofit organization, or private company) must provide matching funds
- Recipients must report to the authority on the uses and outcomes of the grant within one year

6 **Federal research and development support program.** Authorizes the authority to establish a federal research and development support program to increase and coordinate efforts to obtain federal funding for research of primary benefit to qualified science and technology companies, colleges and universities, and nonprofit research organizations.

Specifically, this program is to:

- Identify potential federal funding sources
- Make grants to qualified science and technology companies

- Help develop federal Small Business Innovation (SBIR) or Small Business Technology Transfer (STTR) proposals
- Match SBIR and STTR awards (subject to an annual $1.5 million funding limit)

7 **Industry innovation and competitiveness program.** Authorizes the authority to create an industry technology and competitiveness program to:

- Provide matching funds to help startup of qualified science and technology companies
- Fund efforts to retain engineering, science, and technical jobs in Minnesota
- Fund science and technology industry growth clusters

This program is subject to the following limits:

- The authority must establish written criteria for the award and use of the grants
- The recipient (college, university, nonprofit organization, or private company) must provide matching funds
- Only 15 percent of the grants may be used for overhead
- Recipients must report to the authority on the uses and outcomes of the grant within one year

8 **Minnesota science and technology authority; powers.** Provides that the authority has all of the powers necessary to carry out its purposes, including the power to make grants and loans and to pay for reasonable administrative expenses, including staff and professional fees. Administrative costs are limited to five percent of the first $5,000,000 in the fund and two percent of any balance in excess of $5,000,000.

In making grants, the authority is directed to give priority to qualified science and technology businesses that have "demonstrable economic benefits to the state" by creating jobs, attracting federal money, or creating new businesses.

In making grants to colleges, universities, and nonprofit research organizations, the authority is to give priority to proposals that:

- Promote collaboration with private businesses;
- Attract new research entities, talent, or resources to Minnesota; or
- Attract significant researchers and resources from outside of Minnesota.

Interest charged on the loans and other revenues from the fund's transactions, including required repayments, go back to the corpus of the fund.

9 **Repayment.** Requires the recipient of an award, grant, loan, or other financial assistance to repay all or part of it, if the recipient moves out of Minnesota or ceases operation in the state within three years after it received the grant. If the relocation or closing occurs within two years of receipt, the entire amount must be repaid. Relocations or cessation of operation occurs after two years and before three years require repayment of 75 percent of the amount.

10 **Expiration.** Provides the law expires when the Minnesota Science and Technology Authority expires by law (June 20, 2018). Any unused money in the fund at that point would be returned to the general fund.

11 **Data disclosure; income tax reciprocity benchmark study.** Authorizes the commissioner of revenue to share data with the Wisconsin secretary of revenue for purposes of conducting the income tax reciprocity benchmark study provided in section 17. Current law, which authorizes the commissioner to share data with other states for purposes of enforcing tax laws, would not authorize data sharing since there is not currently a reciprocity agreement in effect with Wisconsin.

12 **Subtractions from taxable income; individuals.** Allows an ongoing deduction for contributions of food inventory by S corporations, partnerships, and sole proprietors following the rules that apply permanently to C corporations under the federal and Minnesota taxes and that apply temporarily (through tax year 2011) to businesses taxed under the federal individual income tax. (Minnesota has typically conformed to this deduction in federal update legislation that extends the temporary federal provision. This section would permanently establish these rules without regard to whether they are in effect for federal purposes or not. Double deduction would not be allowed in any years in which Minnesota conforms to the federal rules as part of update legislation.)

Background. Under the general charitable contribution rules, a business contributing inventory is limited to deducting an amount equal to its basis in the inventory (i.e., the costs it has incurred in creating the inventory), or the fair market value, whichever is less. Special rules apply to food inventory that allow a C corporation to deduct a larger amount than its basis. Under this bill, S corporations, partnerships, and sole proprietors would be allowed the same deduction for contributions of food inventory that is available to C corporations. The business would be allowed to deduct the lesser of the following for food inventory (contributed to a nonprofit that distributes or uses the food as part of its charitable mission):

1. Basis plus one-half of the appreciation (fair market value less basis)
2. Two times basis

This deduction is limited to ten percent of the taxpayer's net income from all S corporations, partnerships, and sole proprietorships. The special deduction only applies to "apparently wholesome food"-that is (as defined in federal law), food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws and regulations, even though the food may not be marketable due to appearance, age, freshness, grade, size, surplus or other conditions.

13 **Individual income tax rates.** Decreases the lower and middle individual income tax rates from their current law levels of 5.35%, and 7.05% to 4.75% and 6.75%, phased in over three years. Does not change the 7.85% rate.

- Tax year 2011: no change (5.35% and 7.05%)
- Tax year 2012: 5.25% and 6.85%
- Tax year 2013: 5.15% and 6.85%
- Tax year 2014 and following years: 4.75% and 6.75%

Under current law, the lower and middle rates apply to the taxable income ranges shown in the table for tax year 2011.

	5.35% rate	7.05% rate
Married filing joint	First $33,770	$33,771 to $134,170
Married filing separate	First $16,880	$16,881 to $67,080

Single	First $23,100	$23,101 to $75,890
Head of household	First $28,440	$28,441 to $114,290

The income tax brackets are adjusted annually for inflation; the amounts that appear in the statute are the brackets as they were in 2000, the last time a rate change was enacted.

14 **Research credit.** Increases each of the rates of the research credit by 2.5 percentage points. Under present law, the research credit equals ten percent of the first $2 million of qualifying research and 2.5 percent of the excess over $2 million. This section would increase the percentages to 12.5 percent and five percent.

Background. The research credit is a refundable credit that applies against both the corporate franchise tax and individual income tax for flow-through tax entities (S corporations and partnerships). The credit is based on "qualified research," which is the firm's expenditures on research in the current taxable year minus a base amount. This base amount is based on the research expenditures by the entity during a three-year period (from 1984-1988) as a percentage of its gross receipts, but not to exceed 16 percent. Startup firms have a fixed-base percentage of three percent. (These computations are taken from federal law.) Qualifying research expenditures are largely expenditures on employee compensation (not equipment) for employees, conducting the research. The credit is limited to research conducted in Minnesota and the gross receipts used to determine the base amount are Minnesota gross receipts.

15 **Income tax reciprocity.**

Subd. 1. Agreements with other states. Eliminates the commissioner's authority to terminate reciprocity agreements, and specifies that any reciprocity agreement with Wisconsin must require estimated payments of net revenue loss to be made from Wisconsin to Minnesota in the same fiscal year in which the loss occurred with a final payment with interest made in the next fiscal year . This would largely eliminate the payment time lag in effect for the reciprocity agreement with Wisconsin that was terminated following tax year 2009.

Subd. 2. New reciprocity agreement with Wisconsin. Directs the commissioner to initiate negotiations with Wisconsin, with the objective of entering into a new reciprocity agreement that would be effective for tax year 2012.

Effective date: Subdivision 2 is effective following final enactment, and subdivision 1 is effective when a new agreement with Wisconsin is reached.

16 **Alternative minimum tax; individuals.** Provides a subtraction from alternative minimum taxable income for amounts deducted under the deduction for food inventory provided in section 12.

17 **Income tax reciprocity benchmark study.** Directs the Department of Revenue to work with the Wisconsin Department of Revenue to conduct an income tax reciprocity benchmark study. The study would use information from Minnesota and Wisconsin 2011 income tax returns of individuals who are residents of one state and have earnings in the other state. Requires the study to include:

- The number of residents of each state with earnings in the other state;
- The income earned by residents of one state who work in the other state;
- The change in tax revenue in each state if a reciprocity agreement were implemented under which taxpayers were required to pay income tax only in their state of residence.

Requires the report to be submitted to the legislature by March 1, 2013.

Article 2: Sales and Use Taxes

Overview

Converts the capital equipment exemption from a refund program to an exemption at the time of sale, effective in fiscal year 2014.

Eliminates all early sales tax payments except for the June accelerated payments and returns to the law as it existed before the change enacted during the 2010 session.

Brings the state into compliance with the Streamlined Sales and Use Tax Agreement (SSUTA) by:

- Codifying transitional language regarding rate changes on taxable services;
- Modifying the sourcing for "other" direct mail to match changes in sourcing requirements; and
- Removing "ring tones" from the definition of taxable telecommunication services.

Expands the sales tax exemption for certain goods and services to local governments to include water used directly for public safety purposes.

1 **Sales and use tax.** Eliminates the accelerated remittance schedules for vendors with annual sales tax collections of at least $120,000 for all months except for June payments. Effective for all payments due after July 1, 2011.

2 **Ring tones.** Exempts the purchase of ring tones from sales and use tax by striking "ring tones" from the list of taxable telecommunication services. This change brings Minnesota into compliance with the SSUTA definition of taxable telecommunication services.

3 **Transitional period for services; sales tax.** States that a sales tax rate increase is effective beginning with the first billing period for taxable services starting after the date of the rate change. For a rate decrease, the new rate will apply to bills mailed on or after the date of the rate change. This is current administrative practice.

4 **Transitional services for services; use tax.** Adds the same language in section 3 to the complementary use tax provisions.

5 **Advertising and promotional material.** Defines advertising and promotional direct mail and continues to apply the current sourcing rules. Removes obsolete references to direct pay permits, since these are now one type of exemption certificate rather than a separate permit.

6 **Other direct mail.** Defines "other direct mail" and simplifies the sourcing rules for this item. Under current law, if the purchaser does not provide an exemption certificate or direct pay permit, the seller must source the mail based on each mailing address. This will allow the mail to be sourced to the address of the purchaser instead. Also removes obsolete references to direct pay permits, since these are now one type of exemption certificate rather than a separate permit.

7 **Capital equipment.** Removes the requirement that the sales tax be paid when the equipment is purchased and then refunded. Effective for sales and purchases made after June 30, 2013.

8 **Sales to local governments.** Expands the sales tax exemption for certain goods and services to local governments to include water used directly in providing fire protection by a fire department, fire protection district, or fire company providing services to the state or a political subdivision. The exemption is retroactive to June 30, 2007; however, no refunds will be made for taxes paid before January 30, 2010.

9 **Refund; appropriation.** Removes the sales tax refund provisions that apply to capital equipment refunds, which will become unnecessary when the exemption for purchase of capital equipment at time of sale takes effect. Effective for sales and purchases made after June 30, 2014.

10 **Repealer.** Repeals the penalty and safe harbor provisions related to the early remittance schedules eliminated in section 1.

Article 3: Special Taxes

Overview

This article converts the excise tax and health impact fee on moist snuff from a tax based on the wholesale sales price of the product to a $1.45 cents per ounce tax.

1 **Moist snuff; definition.** Defines "moist snuff" for purposes of the cigarette and tobacco products excise tax chapter. This definition includes "finely cut, ground, or powdered smokeless tobacco that is intended to be dipped in the oral cavity." It does not include similar products intended to put in the nose.

2 **Tobacco products definition.** Adds moist snuff to the definition of tobacco products.

3 **Tobacco products rate; moist snuff.** Provides a separate tobacco products excise tax for moist snuff equal to $1.45 per ounce. The health impact fee doubles this rate so that the combined tax and fee rate for moist snuff would be $2.90 per ounce. All other tobacco products (chewing tobacco, dry snuff, cigars, and pipe tobacco) would continue to be taxed at 70 percent of the wholesale price.

4 **Use tax.** Makes a conforming change in the tobacco products use tax rate to be consistent with the changes in section 3.

5 **Monthly return; tobacco products distributors.** Requires tobacco products distributors to include in their monthly reports information on the quantity of moist snuff manufactured or brought into Minnesota.

6 **Use tax return; tobacco products consumers.** Requires monthly consumer use tax returns to include information on the quantity of moist snuff brought into Minnesota.

Article 4: Miscellaneous

Overview

Reduces the state general property tax levy on commercial-industrial property, effective for taxes payable in 2012.

Requires the *Tax Incidence Study* prepared by the Department of Revenue to include information on federal tax burden.

Provides appropriations for the expansion of the *Tax Incidence Study* and for the new income tax reciprocity benchmark study.

1 **Tax incidence study.** Directs the commissioner of revenue to include information on the distribution of federal taxes paid by Minnesota residents in the *Tax Incidence Study*, which is presented to the legislature in March of odd-numbered years. Effective beginning with the study due in March of 2013.

2 **State property tax.** Reduces the state general tax levy amount for commercial-industrial property to $771.087 million, effective for taxes payable in 2012. Under present law, the portion of the payable 2011 levy imposed on commercial-industrial property $787.687 million. Sets the general levy amount for seasonal-recreational property at the current law level of $40.585 million, effective for taxes payable in 2012.

3 **Apportionment of state property tax.** Strikes language apportioning the state general levy 95 percent to commercial-industrial property and 5 percent to seasonal recreational property, consistent with the reduction in the commercial-industrial portion of the levy in section 2. Instead the levy on each type of property will increase from the new base amounts set for taxes payable in 2012.

4 **Appropriations.** Appropriates $115,000 in fiscal year 2012 and $215,000 in fiscal year 2013 to the commissioner for the income tax reciprocity benchmark study in article 1, and $15,000 per year on an ongoing basis to the commissioner for the expansion of the *Tax Incidence Study* to include federal tax burden in section 1.