HOUSE RESEARCH

Bill Summary

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Subject: Replace certain existing taxes with the fair tax

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Overview

Eliminates the personal income tax, the corporate franchise tax and equivalent industry taxes, a number of excise taxes, including the existing sales tax, and establishes a framework for replacing these taxes with a very broad sales tax—referred to as the "fair tax". The commissioner of revenue would determine the fair tax rate needed to make the new tax revenue neutral compared to the repealed taxes. The bill also provides for a monthly credit to all households equal to the average monthly amount of fair tax paid by persons living at the poverty level, based on household size.

The bill requires the commissioner to determine the needed tax rate, calculate the monthly rebate, and in consultation with an advisory commission established in this bill, to develop the additional legislation and procedures needed to effectuate the repeal of the old taxes and the implementation of the new fair tax.

The repeal of existing taxes and the implementation of the fair tax would be delayed until January 1, 2020, to allow time for the commissioner of revenue to identify and the legislature to pass all legislation necessary to implement the proposed tax changes.

The fair tax would apply to:

- personal consumption of almost all goods and services including financial services and insurance premiums, purchases from government service enterprises, and fund-raising sales by nonprofits;

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- direct compensation (wages and benefits) paid by households to persons providing services that would otherwise be subject to the fair tax; and
- direct compensation (wages and benefits) paid by state and local governments to provide government services, except for educational services or services provided by a government enterprise.

The following purchases would be exempt from the fair tax:

- business inputs;
- spending on education;
- purchases by nonprofits to meet their nonprofit purposes;
- purchases by the federal government and by state and local governments using federal funds, to the extent prohibited by federal law; and
- investments purchases.

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1 **Person.** Amends the definition of "person" to exclude businesses and other organizations when the context of the language clearly does not allow their inclusion.

2 **Sales price.** Removes the exclusion of interest and finance charges from the taxable sales price. These would now be included in the price subject to the fair tax.

3 **Telecommunications services.** Eliminates the carve outs from the definition of telecommunications services since all of these services are subject to the fair tax.

4 **Additional fair tax definitions.** Defines a number of new words and phrases used in the fair tax system. These include:

Subd. 2. Fair tax. A sales and use tax, incorporated into the sale price of all taxable goods and services, that applies to virtually all final consumption and exempts virtually all intermediate goods and services.

Subd. 3. Basic interest rate. Defined on a monthly basis for short-term, mid-term, and long-term debt, investments, and leases; based on average market yields for federal government obligations of various lengths.

Subd. 4. Business purpose. Purchases made for use in a trade or business. The term is used to exclude purchases of business inputs from the fair tax, to reduce tax pyramiding.

Subd. 5. Business use conversion. Defined as a taxable good or service on which the fair tax is paid that in the end is used 95 percent or more for business purposes.

Subd. 6. Dependent. Defines dependent to exclude "emancipated minors" but includes students over the age of 18 who receive at least 50 percent of their support from a parent or guardian. This definition is used in defining "qualified family" and eliminating the "marriage penalty" in the rebate contained in section 14.

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Subd. 7. Education and training costs. Defines education and training costs to include tuition but exclude room and board and student activity fees. This definition is used in exempting education costs, including higher education costs, from the fair tax.

Subd. 8. Explicitly charged fees. Defines financial services fees that are subject to the fair tax.

Subd. 9. Financial intermediation services. Defined to include both explicitly and implicitly charged financial services. Applies to financial and insurance services.

Subd. 10. Government enterprise. Defined as an entity operated by the federal, state, or local government that charges at least $2,500/calendar quarter from citizens for its goods and services.

Subd. 11. Gross imputed amount. The amount of interest paid on an investment or debt over the amount that would be generated by the basic interest rate defined in subdivision 3.

Subd. 12. Gross payment. The total amount charged for a good or service, including the amount of the fair tax.

Subd. 13. Implicitly charged fees. The imputed amount of fees built into certain financial goods or services (i.e. administrative fees built into "free" checking).

Subd. 14. Intangible property. Defined as copyrights and trademarks, patents, good will, financial instruments, and other items deemed intangible under state law. Intangible property does not include leases and rents on tangible personal property.

Subd. 15. Investment purpose. Defined as property purchased strictly for appreciation purposes or the production of income.

Subd. 16. Mixed use property. Property or a service that is used both for private taxable consumption and for business use purposes.

Subd. 17. Net payment. The total amount charged for a good or service, excluding the amount of the fair tax.

Subd. 18. Nonprofit organization. Organizations exempt from federal taxes under section 501(c) of the Internal Revenue Code and operated exclusively for charitable, religious, fraternal, civic, or educational purposes.

Subd. 19. Produce, provide, render, or sell taxable property or services. Defines when a product or service is actually used as an input to business, rather than purchased for final consumption. In addition to the traditional business inputs these include goods and services used in research and development and purchases by an insurer on behalf of an insured individual if the insurance contract is taxed as financial intermediation services (see subdivision 9).

Subd. 20. Qualified family. Means a qualified individual (adult) and spouse as well as all dependents of either. An "emancipated minor" may be a qualified family.

Subd. 21. Qualified individual. Defined as a resident of the state of Minnesota that has a valid Social Security number and is not a "dependent" as defined in subdivision 6.

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Subd. 22. Taxable employer. Defined as a household employing domestic staff or a government providing goods and services other than those provided by government enterprises (see subdivision 10).

Subd. 23. Taxable property or service. "Taxable property" includes tangible personal property, digital products, leases of tangible personal property or digital products, and the portion of mixed use property related to personal use. "Taxable services" mean all services including financial intermediation services, and wages paid to employees of taxable employers, as defined in subdivision 22. It also includes all sales of property and services by a nonprofit organization for fund-raising purposes.

Subd. 24. Used property. Defined as all property for which the tax under this section has been paid, or the property was held for nonbusiness reasons prior to the date the fair tax goes into effect.

Subd. 25. Wages. Defined as all compensation paid to an employee for their work, including insurance and other benefits.

5 **Generally.** Sets the rate for the fair tax, which is calculated under section 13, to be revenue neutral compared to the revenue raised by the current sales tax and the other taxes repealed in section 7.

6 **Constitutionally required sales tax increase.** Requires the 3/8th percent legacy tax to be adjusted downward, as provided in section 13, to compensate for the broader sales tax base defined in this bill. The aim is to make the change revenue neutral for the funds that receive money from this dedicated tax.

7 **Prohibition on certain taxes.** Prohibits the imposition of any of the following taxes, after imposition of the fair tax:

- individual income tax;
- corporate franchise taxes;
- insurance taxes;
- occupation taxes; and
- any other sales excise or gross receipts tax other than the motor fuel tax, the fair tax, or the motor vehicle sales tax.

8 **Conversion of business purchases to personal use.** Provides that a use tax is owed on goods and services that are purchased exempt from the fair tax as a business purchase but are subsequently used more than 5 percent for personal use. This is the corollary to the refund of fair tax paid on personal purchases that are subsequently converted to business use found in section 11.

9 **Retailer voluntarily registering to collect and remit sales tax.** Requires that a remote seller voluntarily collecting and remitting the state sales tax be compensated for the administrative costs of collecting the tax. The commissioner of revenue must develop a compensation methodology. If compensation is offered to retailers required to collect and remit the tax, the compensation for retailers volunteering to collect and remit the tax must be at least 25 percent

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higher. Most large remote sellers may soon be required to collect the tax under current statutory language.

10 **Exemptions.** Provides the list of transactions exempt from the new fair tax. These include:

- purchases of goods and services for a business purpose;
- purchases for use outside of the state;
- purchases for an investment purpose;
- purchases by a government enterprise;
- education and training costs paid to an accredited institution of higher education and tuition for private elementary and secondary education;
- motor fuels subject to tax under chapter 296A;
- purchases and sales to certain nonprofit organizations when used to meet their charitable, civic, educational or other nonprofit purchase including senior citizen groups, and groups serving youth; and
- purchases by the federal government and by the state and local governments with certain federal funds. (Federal law does not allow the state to tax the federal government and its agencies. There are also a number of federal laws prohibiting taxation of certain purchases made with federal funds.)

11 **Credits and refunds.** Lists the allowed credits and refunds under the fair tax. These include:

- business use conversion credit on tax paid on items that end up used at least 95 percent for business purposes;
- credit for tax paid on intermediate goods and services;
- credit for tax paid on goods and services exported and used out of state;
- credit for tax paid on amounts actually paid out as insurance claims if the fair tax was paid on the insurance premium;
- credit for bad debt;
- credit for excess taxes paid; and
- a monthly rebate to each qualified family, as required in section 14.

12 **Fair tax legislation.** Directs the commissioner of revenue to develop legislation to repeal the taxes in section 7 and implement the new fair tax. Establishes an advisory task force to help develop the legislation.

Subd. 1. Proposed legislation. Outlines the minimum provisions that need to be in the legislation.

Subd. 2. Fair Tax Advisory Task Force. Sets up the task force and its membership and outlines its duties.

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13 **Fair tax rate.** Requires the commissioner of revenue to determine the general fair tax rate needed to offset the repeal of the other state taxes, and the rate change necessary so that the legacy tax continues to collect roughly the same amount as under current law.

14 **Monthly sales tax rebate.** Requires the commissioner of revenue to determine a method to provide all qualified families a monthly fair tax rebate equal to the fair tax rate multiplied by the average monthly family income, under the annual poverty guidelines. If there are two qualified adults in the household, one gets the allowance for a single person household and the second gets the allowance based on a household size equal to themselves plus the number of dependents in the household.

15 **Repealer.** Repeals the following taxes:

- income and franchise taxes in chapter 290;
- marijuana and controlled substance taxes in chapter 297D;
- cigarette and tobacco taxes in chapter 297F;
- liquor taxes in chapter 297G;
- solid waste management taxes in chapter 297H;
- insurance taxes in chapter 297I; and
- the portions of the existing sales tax statutes under chapter 297A, not necessary under the fair tax.