➲ Designates that this item is a change item

January 27, 2009

The 2009 Minnesota Legislature:

I am pleased to announce Governor Pawlenty's tax initiatives targeted at stimulating economic growth and providing for the future prosperity of Minnesota citizens and businesses. In addition, the Governor is proposing a reduction in local government aids and certain tax credits in order to help solve the nearly $5 billion deficit.

With the current historic economic downturn, the Governor is focusing on tax initiatives that will help encourage innovation, entrepreneurship and job growth. The Governor proposes a multi-pronged approach that will help Minnesota be more competitive for the future and will help retain and grow jobs in the near term. The Governor's proposal includes the following key components:

- Corporate franchise tax rate reduction from 9.8 percent to 4.8 percent phased in over the next six years
- Job Growth Investment Tax Credit to stimulate formation of early-stage capital in new emerging businesses
- Small Business Investment Tax Credit in the form of an insurance premium tax credit to encourage investment in Minnesota small businesses by certified capital companies
- 25% refundable tax credit for small business owners that invest in their businesses over the next year
- New capital gains exemption for qualifying investments by small businesses
- Upfront sales tax exemption for purchases of capital equipment
- Allowing the immediate expensing of qualifying business purchases (Section 179 expensing)
- Creation of Green JOBZ tax-free zones to encourage growth of new renewable energy jobs throughout Minnesota.

The current economic downturn has resulted in a historic budget deficit that will require spending reductions in virtually all areas of the state budget. The Governor recommends a reduction in non-school local government aids, county program aids, homestead market value credit, and other local government aids and credits. The reductions are structured so they are spread as equitably as possible across jurisdictions in order to minimize budget disruptions.

The budget deficit provides a tremendous opportunity to rethink how government services are delivered. All levels of government will need to closely analyze spending and priorities in order to focus on core services, and ensure those services are provided in the most efficient and cost-effective manner. Government needs to tighten its spending belt just as taxpayers and businesses have done. To encourage greater collaboration and service delivery, the Governor is providing an aid incentive for Minnesota's 87 counties to enter into regional enterprises for their human service programs in order to consolidate and reduce costs.

I look forward to working with you to help get these initiatives passed for the benefit of our citizens and employers.

Respectfully,

Ward Einess

Tax Policy, Aids and Credits Budget Presentation

Summary

The Governor's tax initiatives for the FY 2010 – 2011 biennium include several changes to tax policy and local aids and credits expenditures. These initiatives focus on the following strategic outcomes:

- Economic stimulus and business growth incentive
- Increased efficiency and cooperation among all levels of government
- Relief for a historic budget deficit

The table on the next page and the succeeding narratives describe the Governor's recommended tax changes and their fiscal impact. Some of the tax-related items affect other policy areas and more information on them can be found in other parts of the state budget presentation.

Below is a table that helps to summarize the Governor's tax initiatives by separating out the total dollars by outcome type. The positive numbers represent expenditures or revenue losses.

Governor's FY 2010-11 Tax Policy, Aids and Credits Budget Summary

Expenditure/Revenue Type (dollars in 000s)	Gov's Rec. FY 2010	Gov's Rec. FY 2011	Gov's Rec. FY 2012	Gov's Rec. FY 2013
Economic Stimulus	**125,080**	**146,680**	**205,985**	**249,315**
County Program Reform[1]	**-**	**-**	**-**	**-**
Budget Deficit Relief	**(172,160)**	**(364,260)**	**(309,240)**	**(311,140)**
Federal Conformity	**11,600**	**(5,410)**	**(4,705)**	**(2,845)**
Shift changes and tax change interaction	**(6,797)**	**24,717**	**20,511**	**20,293**

[1] Spending reductions in this chart assume that all counties will conform with the Governor's county service reform initiative.

Governor's Recommended Tax Initiatives for the 2010-11 Biennium (dollars in '000s)

Governor's Recommendations*	Fund	FY 2010 Gov Rec	FY 2011 Gov Rec	FY 2010-11 Gov Rec
Economic Stimulus				
Reduction in the Business Franchise Tax Rate	General	20,000	100,000	120,000
Reinvestment Tax Credit	General	50,000	-	50,000
Angel and Early Stage Capital Incentives	General	-	-	-
Green JOBZ	General	1,150	2,500	3,650
Capital Equipment Upfront Exemption	General [1]	36,730	41,480	78,210
Section 179 Business Expensing (Adoption of Federal Provision)	General	17,200	2,700	19,900
Capital Gains Exemption [2]	General	-	-	-
Subtotal		**125,080**	**146,680**	**271,760**
Increased Government Efficiency				
County Program Reform[3]	General	-	-	-
Subtotal		**-**	**-**	**-**
Budget Deficit Relief				
County Program Aid Reduction[3]	General	(42,740)	(83,150)	(125,890)
Local Government Aid Reduction	General	(77,800)	(168,000)	(245,800)
Market Value Homestead Credit Reimbursement Reduction[4]	General	(37,040)	(40,230)	(77,270)
Adjustment to Renter's Property Tax Refund Formula	General	-	(50,700)	(50,700)
Elimination of Political Contribution Refund Program	General	(4,800)	(6,800)	(11,600)
Cap Sustainable Forest Incentive Act Payments	General	-	(5,500)	(5,500)
Taconite State Aid Appropriation Reduction	General	(5,480)	(5,480)	(10,960)
PILT Adjustment	*General*	*(4,300)*	*(4,400)*	*(8,700)*
Subtotal		**(172,160)**	**(364,260)**	**(536,420)**
Federal Conformity				
Federal Tax Law Conformity	General	11,600	(5,410)	6,190
Subtotal		**11,600**	**(5,410)**	**6,190**
Payment Shifts and Tax Change Interactions				
Education Aid Payments Shift	General	(6,797)	147	(6,650)
Property Tax Refund and Income Tax Interaction	General	-	24,570	24,570
Subtotal		**(6,797)**	**24,717**	**17,920**

* Recommended items in italics are primarily being carried in other budget areas and are presented here to give an overall view of all the tax-related budget initiatives.

[1] This figure includes a $3.260 million revenue reduction to natural resources and arts funds.

[2] This change will not impact the general fund until FY 2014

[3] Spending reductions in this chart assume that all counties will conform with the Governor's county service reform initiative.

[4] This line combines residential and agricultural homestead market value credit reductions.

Change Item: Reduction in Business Franchise Tax Rate

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	(20,000)	(100,000)	(180,000)	(230,000)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$20,000	$100,000	$180,000	$230,000

Recommendation

The Governor recommends reducing the business tax rate of 9.8% to 4.8% over a period of six years. This would reduce Minnesota's business franchise tax rate from one of the highest in the nation to a more competitive rate. A reduction in rates will help encourage businesses to grow and invest in Minnesota.

Background

Minnesota's current business franchise tax rate is 9.8%, which is one of the highest in the nation. This high tax rate can discourage investment in Minnesota and places our businesses at a competitive disadvantage. The business franchise tax is paid by C-corporations which includes businesses of all sizes. Minnesota's business income tax is a volatile and regressive tax. Because a reduced business tax rate will increase investment in Minnesota, most of the benefits will ultimately be passed on to Minnesota consumers in the form of reduced prices or to Minnesota employees in the form of higher wages and benefits.

The proposal will phase in a business tax rate reduction over next six years starting in calendar year 2010 as follows:

Tax Year	Proposed Tax Rate
2010	8.8%
2011	7.8%
2012	7.3%
2013	6.8%
2014	5.8%
2015	4.8%

Relationship to Base Budget

When fully phased in, this proposal would result in a 51% reduction in the business tax rate, which will lower general fund forecasted revenues.

Key Goals and Measures

This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: Minnesota Statute 290

Change Item: Reinvestment Tax Credit

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	(50,000)	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$50,000	$0	$0	$0

Recommendation
The Governor recommends the creation of the Reinvestment Tax Credit which is a 25% refundable tax credit targeted at small businesses that reinvest in their businesses in 2009.

Background
To encourage job growth and new investments in Minnesota businesses, the Governor recommends the creation of a new refundable tax credit to provide incentives for businesses that invest in their businesses quickly. The credit will be capped at a total of $50 million. The refundable credit will be targeted to small business owners for qualifying business investments. The qualifying investments would include various business investments such as those eligible for Section 179 expensing under the federal tax code (i.e. machinery, equipment, furniture, certain structures and other tangible personal property). The credit would be available to businesses in FY 2010 for certain qualifying investments that occur in 2009.

Relationship to Base Budget
This will be a one-time general fund revenue reduction of $50 million.

Key Goals and Measures
This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: Minnesota Statute 290

Change Item: Angel and Early-Stage Capital

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	0	0	(12,500)	(12,500)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$0	$0	$12,500	$12,500

Recommendation

The Governor recommends providing $50 million in tax incentives for investments in small, emerging businesses, stimulating availability of early-stage capital for these job-creating businesses. The tax costs would be spread over four fiscal years between FY 2012 and FY 2015. Half of these investments would be targeted to "green" investments that support the state's 25x25 renewable energy standards.

Background

Job Creation Investment Tax Credit

This proposal would provide $12 million in tax incentives for angel investments in regional investment funds, stimulating formation of early-stage capital to invest in emerging businesses. It would provide for the following:

- A 25% tax credit for investments in funds that invest in qualified businesses that meet certain criteria; to encourage longer term investments, the credit would be allowed only after an investment has been held for four years.
- A maximum of $3 million in credits would be granted per year for four years; a maximum credit of $200,000 per investor and $1 million per fund would be allowed each year.
- Up to 20 funds, geographically dispersed, would be qualified, and each fund would need to invest at least 60% of its money in qualified businesses within the fund's region.
- 50% of investments must go to green technology.

Small Business Investment Tax Credit

This proposal would provide $38 million in tax incentives to insurance companies for early-stage investments in certified capital companies, which would be required to invest in qualified businesses in Minnesota. It would provide for the following:

- A 60% tax credit, in the form of an insurance premium tax credit, for insurance company investments in approved certified capital companies; the credit would be allowed only in the fifth calendar year after the investment is made, at a rate not to exceed 20% of the earned credit in any taxable year.
- Investments totaling $63 million would be eligible for the credit, creating a large pool of capital for investment in small, emerging businesses.
- 30% of the businesses would need to be located in Greater Minnesota or in low-income communities.
- 50% of the investments must go to green technology.

The tax cost of these proposals would be deferred until 2012 and later. Businesses receiving the investment would need to be headquartered in Minnesota, have 60% of their employees working in Minnesota, have fewer than 100 employees, have less than $2 million in sales, be engaged in certain types of business (e.g., clean-tech, biotech, other manufacturing, etc.) and not engaged in other types of business (e.g., real estate, banking, professional services, etc.) among other criteria.

Relationship to Base Budget

Not applicable.

Key Measures

Both elements of the proposal support the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Between the two programs there will be the formation of an additional $110 million in new capital for new and emerging technology firms — a sum that is absent in today's economic development landscape. In terms of potential impact, for comparison purposes, RAIN Source Capital, a private nonprofit working to establish regional venture capital pools, has generated $77 million that has been invested in 55 companies located in 41 communities, creating 2,200 jobs.

Statutory Change: New statutory language will need to be drafted for both elements of the proposal.

Change Item: Green JOBZ

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	(1,150)	(2,500)	(3,050)	(3,550)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$1,150	$2,500	$3,050	$3,550

Recommendation

The Governor recommends the creation of a "GreenJOBZ" initiative patterned after the original JOBZ program, but with three major changes:

1) GreenJOBZ would be exclusively for companies that create renewable energy, represent manufacturing equipment or services used in renewable energy, or that create a product or service that lessens energy use or emissions.
2) Companies would receive benefits for twelve years for all agreements signed by the end of 2015.
3) Projects could be anywhere in Minnesota, including the metro area.

Background

In the green/renewable energy sector, Minnesota has excellent goals to achieve greater use of green/renewable sources, but it lags other states in jobs in this sector. Providing a new GreenJOBZ program that has twelve years of benefits, and the ability to bring new investment anywhere in Minnesota, will help Minnesota compete for investment that will promote a green economy. The manufacturing and services *will* occur, but there is no certainty that they will happen in Minnesota without special incentives.

The tax implications associated with a green/renewable focused JOBZ are more than matched by the direct and indirect economic impact of the investments. GreenJOBZ will be targeted for projects that are green/renewable manufacturing-related. If GreenJOBZ is not provided in the competitive marketplace for selection of new projects, it is likely that these projects would not occur in Minnesota.

Relationship to Base Budget

Not applicable.

Key Goals and Measures

This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: New language is needed to create the "GreenJOBZ" program.

Change Item: Capital Equipment Upfront Exemption

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	(35,300)	(39,650)	(14,370)	(7,510)
Other Fund				
Expenditures	0	0	0	0
Revenues	(1,430)	(1,830)	(791)	(430)
Net Fiscal Impact	$36,730	$41,480	$15,161	$7,940

Recommendation
The Governor recommends changing the current sales tax refund for capital equipment to an upfront sales tax exemption at the time of purchase effective January 1, 2010. This will help businesses invest in capital equipment in Minnesota by removing this burdensome current law refund provision. The refund system is a burden both for businesses and for the state to administer. This will lessen the cost of these purchases by reducing the upfront costs, which can cause cash flow concerns particularly for small businesses.

Background
Under current law, Minnesota provides an exemption from sales and use tax for certain capital equipment purchases. The sales or use tax is paid at the time of purchase, and the exemption is allowed upon the filing of a claim for refund by the purchaser. To qualify for the exemption, the capital equipment must be used in Minnesota by the purchaser or lessee for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail. Repair and replacement parts and accessories are included in the exemption. The exemption also applies to materials and supplies used to construct and install the equipment and to construct special purpose buildings used in the production process. Businesses have 3 ½ years from the date of purchase or lease to file a refund claim.

The exemption for capital equipment purchased for new or expanding manufacturing facilities was enacted in 1989 and replaced the previous reduced tax rate of 4 percent. The exemption was extended to mining in 1990 and to on-line data retrieval equipment in 1993. In 1994, the 6.5% rate on replacement capital equipment was reduced, and in 1997, was ultimately changed to a complete exemption with a refund requirement. Businesses must track eligible purchases and may request a refund twice a year.

Between 2,000 and 2,500 refunds claims are paid each year.

Relationship to Base Budget
The upfront exemption reduces both general fund revenues (6.5% of the sales tax) and the natural resources and arts funds (0.375% of the sales tax). There is a larger cost in the first two years and smaller on-going costs.

Key Measures
This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: Minn. Stat. § 297A.68

Change Item: Section 179 Business Expensing

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	(17,200)	(2,700)	4,725	4,675
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$17,200	$2,700	$(4,725)	$(4,675)

Recommendation

The Governor recommends fully adopting the current federal tax provisions relating to federal tax law Section 179 business expensing of qualifying property assets for purposes of individual and corporate franchise income tax. The proposal would allow the full federal expensing of qualifying business assets purchased in 2009 and 2010. The ability to expense equipment purchases will encourage small businesses to invest in upgrading or expanding their operations in Minnesota by reducing their costs. Conformity with the federal law will also simplify the compliance costs both for businesses and the Department of Revenue.

Background

Section 179 of the federal tax code allows a taxpayer to treat the cost of qualifying business property as an expense in the year the property is placed in service, rather than spreading those deductions over several years. For federal tax purposes, the maximum annual amount expensed is $133,000 for tax year 2009. If the taxpayer places more than $530,000 of qualifying property in service during 2009, the limitation is reduced by one dollar for each dollar that the cost exceeds $530,000. The limitations for 2010 are slightly higher because they are indexed for inflation. Under current federal law, the federal limits will revert to those under prior law, $25,000 and $200,000, beginning with property placed in service in 2011.

This provision was adopted in 1982. The maximum deduction was increased in 1993 and 1996. In 2003, the amount of allowable expensing was temporarily increased for tax years 2003 through 2005. The increase was extended for tax years 2006 to 2010. For budgetary reasons, Minnesota did not adopt the increased limits for 2006 to 2010. For Minnesota tax purposes, 80% of the difference in expensing allowed under current and prior federal law is added back to income in the year the property is placed in service and the addition is allowed as a subtraction in equal parts over next five years.

Relationship to Base Budget

This proposal will result in revenue loss to general fund in FY 2010 and FY 2011 as taxpayers will not be required to add back 80% of the difference for their purchases placed in service in 2009 and 2010. This will result in increases in general fund revenues in FY 2012 and FY 2013 as taxpayers receive the tax benefit in the first year versus taking the subtraction over the next five years.

Key Goals and Measures

This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: Minnesota Statutes, Section 290.01

Change Item: Capital Gains Exemption

Fiscal Impact ($000s)	FY 201	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$0	$0	$0
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$0	$0	$0	$0

Recommendation

The Governor recommends the creation of a capital gains exemption for qualifying investments in small businesses in Minnesota starting in 2009. This will encourage new investment and job growth in Minnesota businesses.

Background

To encourage long-term investments and help job growth, a new capital gains exemption is proposed. 50% of the capital gains from qualifying investments in Minnesota small businesses will be exempt from taxation. The exemption will be available for qualifying investments starting in 2009 and will require a five year holding period.

Relationship to Base Budget

The capital gain exclusion will not impact the general fund budget until FY 2014 and beyond. The tax benefit will not be received until the asset is sold as the investment will require a 5 year holding period.

Key Measures

This initiative supports the *Minnesota Milestones* goal that *Minnesota will have sustainable, strong economic growth.*

Statutory Change: M.S. 290

Change Item: County Program Aid Reduction

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures – CPA Reductions	$(67,740)	$(116,128)	$(98,878)	$(98,878)
Expenditures – CPA Earn Back	$25,000	$32,978	$32,978	$32,978
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(42,740)	$(83,150)	$(65,900)	$(65,900)

Recommendation

The Governor recommends reducing county program aid (CPA) payments by $67.7 million in FY 2010 and $116.1 million in FY 2011. The Governor believes that counties, like all agencies, programs, organizations and individuals that depend on state financial resources must share the burden of solving the current budget problem. The Governor also recommends that counties be provided with an opportunity to earn back a portion of their aid by reforming the way human services programs are delivered. Assuming counties choose to comply with the Governor's county program reform initiative, the net reduction in CPA would be $42.7 million in FY 2010 and $83.2 million in FY 2011. Under this proposal, counties will receive $125.9 million in county program aid from the state in FY 2010-11.

Background

County program aid is paid from the state general fund to counties as general-purpose aid. The total amount of county program aid under current law is $459 million for the FY 2010-11 biennium. In 2003, several county aids were restructured into a single program called county program aid (CPA). At that time, the following individual aid programs were eliminated: homestead and agricultural aid credit, county criminal justice aid, family preservation aid and attached machinery aid. CPA payments are determined using a formula that includes factors such as population, property wealth, crimes, persons receiving food stamps and age (adjusted population for those over 65).

For aids payable in FY 2010, the reduction would be $67.7 million which is calculated as 2.41% of levy plus aid for each county. Counties will be eligible for a smaller reduction of $42.7 million or 1.53% if they comply with the Governor's initiative to form 15 regional human service authorities. For aids payable in FY 2011, the reduction is 4.14% of levy plus aid for each county, based on payable 2009 levy plus aid. Counties again would be eligible for a smaller reduction totaling $83.2 million or 2.97% if they comply with an initiative to reform human services administration. For aids payable in FY 2012 and thereafter, the reduced appropriation would be distributed through the county program aid formula.

CPA payments are made twice a year, one in July and one in December. County fiscal calendars operate on a calendar year basis whereas the state operates on a July 1st – June 30th fiscal calendar. Therefore aid reductions for state FY 2010 will affect FY 2009 county budgets. The reduction amounts reflected above shift approximately two-thirds of the reduction to the second year of the biennium thus minimizing the affect on counties that have already set their FY 2009 budgets.

Relationship to Base Budget

For aids payable in FY 2010, the proposed reduction is $42.7 million which is 1.53% of levy plus aid for each county. For aids payable in FY 2011 the proposed reduction is $83.2 million which is 2.97% of levy plus aid. For aids payable in FY 2012 and thereafter, the reduced appropriation would be distributed through the county program aid formula. Counties could be subject to further reductions in FY 2012 and thereafter if they do not comply with the county program reform initiative. This proposal assumes that counties would choose to comply with the Governor's initiative to form 15 regional human service authorities.

Statutory Change: 477A.0124 and 477A.03

Change Item: Local Government Aid Reduction

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$(77,800)	$(168,000)	$(129,500)	$(129,500)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(77,800)	$(168,000)	$(129,500)	$(129,500)

Recommendation

The Governor recommends reducing local government aid payments by $77.8 million in FY 2010 and $168 million in FY 2011. The Governor believes that cities, like all agencies, programs, organizations and individuals that depend on state financial resources must share the burden of solving the current budget problem. With this reduction, cities will still receive $823 million in local government aid from the state in FY 2010-11.

Background

Minnesota has a long history of supplementing local government revenues with state general fund aid payments. This is done in order to alleviate the burden on the property tax system.

Advocates of state aid payments have advanced several reasons for this financial relationship including:

- State aid payments help communities with limited property wealth to provide basic local services without undue property tax burden.
- State aid payments help offset the cost of state mandates.
- State aid payments help limit the overall property tax burden.

Critics of state aid payment have also advanced several concerns about this financial relationship including:

- State aid distribution formulas are often based more on historical spending patterns than need.
- State aid programs do not have specific objectives or accountability measures.
- State aid drives increased spending by local governments; it does not reduce property taxes.

Local Government Aid (LGA) is distributed on a formula basis using several factors to determine the size of payment to an individual city. For cities with population of 2,500 or more need is determined by factors such as population decline, age of housing stock, household size and number of vehicular accidents. For cities with population less than 2,500, need is determined by population decline, age of housing stock, percent of commercial and industrial property and a population adjustment factor.

LGA is paid by the state in two payments, one in July and one in December. Cities operate on calendar year budget whereas the state operates on a July 1 – June 30 fiscal year. The reduction of $77.8 million in FY 2010 represents less than one-third of the total cut for the biennium so as to minimize the immediate impact on cities that may have already set their 2009 budget—local government aid payments for state FY 2010 are sent in July and December 2009. LGA is distributed to 763 cities while 91 cities receive no LGA. Additionally, 116 cities would receive at least a partial reduction in their homestead and agricultural market value credits.

This proposal is coupled with market value credit reductions and is structured to fairly and evenly distribute the reductions across all cities. The reductions to cities are calculated to equal 5.05% of levy plus aid for each city. The reduction would first be taken from the certified 2009 LGA and then from the market value homestead credit if there is not enough aid. For aids payable in 2010 the total reduction is 11.27% of levy plus aid for each city. For aids payable in 2011 and thereafter the reduced appropriation will be distributed through the LGA formula.

Relationship to Base Budget

This proposal would reduce FY 2010-11 LGA general fund spending by approximately 23%.

Statutory Change: MS 477A.011 and 477A.03

Change Item: Residential HMVC Reimbursement

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	($32,700)	($35,860)	($35,100)	($34,300)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($32,700)	($35,860)	($35,100)	($34,300)

Recommendation

The Governor recommends reducing the Homestead Market Value Credit paid to local governments by $32.7 million in FY 2010 and $35.86 million in FY 2011. This proposal will eliminate the reimbursement paid to townships and result in a partial reduction to some cities. This recommendation is included to ensure that all local governments, even those that are less reliant on local government aid, share the burden of the state's historic budget shortfall.

Background

Residential and agricultural homesteads receive a benefit from the state-funded market value credit that is shown on their property tax statement as a subtraction from their property taxes. The credit amount is equal to 0.4 percent of market value up to a maximum credit of $304, which occurs on a home valued at $76,000. The credit begins to decrease on homes valued at more than $76,000. Homes valued above $414,000 receive no credit. Local governments receive a state reimbursement for the reduction in property taxes to homeowners. The reimbursement is paid out twice a year to local governments, once in October and once in December.

Under this proposal, the estimated $11 million in reimbursements that would be paid to townships in FY 2010 would be eliminated. Reimbursements to cities would be reduced by $21.7 million.

Under current law levy limits, FY 2010 reductions would not be eligible for additional levy authority. After 2010, it is assumed that local governments receiving a reduction in reimbursement would increase property tax levies. The resulting increase in property tax burden on homesteads would result in higher state-paid direct relief to homeowners through the property tax refund program. The increased payments to homeowners are reflected in this document under the property tax refund and income tax interaction change item.

Market value credit reimbursement reductions are coupled with reductions to local government aid so as to fairly distribute aid reductions to all local governments.

Relationship to Base Budget

This proposal will reduce the market value homestead credit general fund expenditures by 13.1 percent for the biennium.

Statutory Change: M.S. § 273.1384

Change Item: Reduce Agricultural MVC Reimbursements

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	($4,340)	($4,370)	($4,360)	($4,360)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($4,340)	($4,370)	($4,360)	($4,360)

Recommendation

The Governor recommends reducing the Agricultural Homestead Market Value Credit paid to local governments by $4.34 million in FY 2010 and $4.37 million in FY 2011. This proposal will eliminate the reimbursement paid to townships and result in a partial reduction to some cities. This recommendation is included to ensure that all local governments, even those that are less reliant on local government aid, share the burden of the state's historic budget shortfall.

Background

Agricultural homesteads, similar to residential homesteads, receive a benefit from the state-funded market value credit that is shown on their property tax statement as a subtraction from their property taxes. For taxes payable in 2007, property classed as Class 2a agricultural homestead is eligible for an agricultural credit. The credit is equal to 0.3 percent of the first $115,000 of the property's market value (base amount). The maximum credit is limited to $345 and this amount is reached at $115,000. The credit is reduced by 0.05 percent of the market value in excess of $115,000, but it is subject to a maximum reduction of $115. This credit decreases as the market value increases to $345,000. At that value, the credit reduction reaches the maximum of $115 and the credit is equal to $230. For any agricultural homestead valued at $345,000 or above, the agricultural homestead credit is $230.

Local governments receive a state reimbursement for the reduction in property taxes to agricultural homesteads. The reimbursement is paid out twice a year to local governments, once in October and once in December.

Under this proposal, the estimated $4.2 million in reimbursements that would be paid to townships in FY 2010 would be eliminated. Reimbursements to cities would be reduced by $140,000.

Under current law levy limits, FY 2010 reductions would not be eligible for additional levy authority. After 2010, it is assumed that local governments receiving a reduction in reimbursement would increase property tax levies. The resulting increase in property tax burden on homesteads would result in higher state-paid direct relief to homeowners through the property tax refund program. The increased payments to homeowners are reflected in this document under the property tax refund program and income tax interaction change item.

Market value credit reimbursement reductions are coupled with reductions to local government aid so as to fairly distribute aid reductions to all local governments.

Relationship to Base Budget

This proposal will reduce the market value agriculture credit general fund expenditures by 17.2 percent for the biennium.

Statutory Change: Minn. Stat. § 273.1384

Change Item: Property Tax Refund: Change Formula

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	0	($50,700)	($51,600)	($52,300)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	($50,700)	($51,600)	($52,300)

Recommendation

The Governor recommends adjusting the rate for calculating property tax refunds for renters so that it more closely reflects actual property taxes paid. The rate attributable to property taxes would be changed from 19 percent of rent paid to 15 percent of rent paid.

Background

Minnesota's property tax refund program provides income-based property tax refunds to residential homeowners and renters. The refund is based on the relationship between the claimant's property tax and household income. For renters, the portion of rent attributable to property taxes is considered to be 19 percent of the rent payment, a rate that was established in 1998.

Property tax reforms enacted in 2001, however, resulted in class rate reductions for most rental property. A Department of Revenue study shows that property taxes now constitute, on average, less than 15 percent of rent paid. Since the goal of the property tax refund program is to refund a portion of property taxes, it is important to update the rate to more closely reflect the actual property tax share of rental payments.

Under this proposal, the percentage of rent attributable to property tax would be reduced to 15 percent.

Relationship to Base Budget

This proposal will result in an approximately 14 percent reduction in general fund spending on the renter's property tax refund program in FY 2010 – 11.

Statutory Change: Minn. Stat. § 290A.03

Change Item: Eliminate Political Contribution Refund

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$(4,800)	$(6,800)	$(6,000)	$(7,100)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(4,800)	$(6,800)	$(6,000)	$(7,100)

Recommendation
The Governor recommends eliminating the political contribution refund program, which will save the state's General Fund $4.8 million in FY 2010 and $6.8 million in FY 2011.

Background
Minnesota's Political Contribution Refund Program allows individuals who contribute to a Minnesota political party, or to candidates for state office or the Minnesota legislature to apply for a refund of their contribution. The maximum refund is $50 for single individuals or $100 for married couples. Only monetary contributions qualify for the refund. To receive a refund, applicants must file form Political Contribution Refund (PCR) with Minnesota Department of Revenue by April 15 of the year following the contributions. Each application for the refund must include an original receipt issued by the candidate or political party receiving the contribution. The amount necessary to pay the refunds is appropriated to the Commissioner of Revenue. The program results in an indirect state appropriation to political parties and candidates for a state office.

As Minnesota faces an historic budget shortfall, not all programs can continue to be funded. Eliminating the political contribution refund program is estimated to save $11.6 million in FY 2010-11 and $13.1 million in FY 2012-13.

Relationship to Base Budget
This proposal will result in approximately $11.6 million in reduced general fund expenditures in FY 2010–11.

Statutory Change: M.S. 270A.03, 289A.50 and 290.01

Change Item: Cap Sustainable Forest Incentive Act Pmt

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$(5,500)	$(6,100)	$(6,900)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$0	$(5,500)	$(6,100)	$(6,900)

Recommendation

The Governor recommends capping the maximum Sustainable Forest Incentive Act (SFIA) per-acre payment at $100,000 per claimant. This cap would take effect beginning for acreage enrolled in 2009 for payment in FY 2011 and would impact four claimants.

Background

The Sustainable Forest Incentive Act (SFIA) was passed in 2001 and allows annual payments to be made to enrolled owners of forested land as an incentive to practice long-term sustainable forest management. The payment rate in 2008 was $8.61 per acre and cannot be less than $7.00 per acre in any year. To be enrolled in the program, a participant must meet all of the following requirements:

- Participants must own 20 or more contiguous acres of land in Minnesota, of which at least 50% is forested. Participants may be private individuals, corporations or partnerships, and can be either residents or nonresidents of Minnesota.
- There can be no delinquent property taxes owed on the land prior to enrolling, and participants must stay current with their taxes while enrolled in the program.
- The land must have an active forest management plan in place that was prepared by an approved plan writer within the past ten years. The plan writer must be approved by the Department of Natural Resources (DNR). All management activities prescribed in the plan must meet the recommended timber harvesting and forest management guidelines created by the Minnesota Forest Resources Council.

Relationship to Base Budget

This proposal would reduce the general fund appropriation by $5.5 million in FY 2011, $6.1 million in FY 2012, and $6.9 million in FY 2013. This proposal would reduce SFIA payment general fund spending in FY 2010 – 11 by 34%.

Statutory Change: M.S. 290C

Change Item: Reduce Taconite State Aid Appropriation

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$(5,480)	$(5,480)	$(5,480)	$(,5480)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(5,480)	$(5,480)	$(5,480)	$(5,480)

Recommendation

The Governor recommends reducing the taconite state aid appropriation from 22 cents per taxable ton of iron ore produced to 7 cents per ton. The taconite state aid amount would still be distributed according to M.S.. 298.28. The Governor believes this reduction in state aid is necessary to deal with the current budget deficit.

Background

In accordance with M.S. 298.285, the taconite state aid appropriation is added to total taconite production tax collected under M.S. 298.27 as if the dollars were taconite production taxes paid by a mining company. The state aid appropriation was enacted in 2001 in response to the shutting down of many mining operations. The aid payment continued, however, even though production tax revenues have rebounded since 2001.

Taconite production tax revenues are distributed based on the formula in M.S. 298.28. Under current law, the annual state aid payment is equal to 22 cents per taxable ton of iron ore produced. The proposal reduces the payment to 7 cents per ton and the total amount available for distribution under M.S. 298.28.

The proposal would reduce amounts available to the Taconite Area Environmental Protection Fund (TEPF) and the Douglas J. Johnson Economic Protection Trust Fund (DJJ), which are remainder accounts that only receive money after all other distributions have been made.

The TEPF is the primary source of funds available to the Office of the Commissioner of Iron Range Resources and Rehabilitation for agency operations, programs and projects. The DJJ is a trust account. Interest from the DJJ also is available to the Commissioner for agency operations, programs and projects.

The proposal would have no impact on distributions made to schools, counties, cities, townships and other recipients under M.S. 298.28 because if there are insufficient funds to cover the distributions to recipients, under M.S. 298.225 this shortfall is made up by the TEPF and DJJ.

Relationship to Base Budget

This proposal would result in a 68% reduction in taconite state aid expenditures from the general fund.

Statutory Change: M.S. 298.285

TAX POLICY, AIDS AND CREDITS

Change Item: PILT Adjustment

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$(4,300)	$(4,400)	$(5,200)	$(5,300)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(4,300)	$(4,400)	$(5,200)	$(5,300)

This change item page is presented for cross reference purposes only. The primary change page and the associated financial impacts are located in the Department of Natural Resources presentation.

Recommendation

The Governor recommends a reduction to the Department of Natural Resources (DNR) in the appropriation for payments in lieu of taxes (PILT).

Background

PILT payments are governed under M.S. 477A.12. The appropriation is made initially to the Department of Natural Resources and then transferred to the commissioner of the Department of Revenue for payment. They are intended to help counties that have a large amount of state owned land. Because state owned land does not pay local property taxes, delivering even basic level services to that state owned land can be financially difficult for local governments.

PILT payment obligations have grown over the last several years, and they are expected to keep growing. The current forecast base for general fund PILT is $21.787 million in FY 2010 and $21.905 million in FY 2011.

The Governor is proposing to modify the PILT payment formula to provide 80% of funding currently forecast. A reduction to PILT payments does not affect operations of the DNR, but it is a reduction is payments to counties.

Relationship to Base Budget

This proposal will continue to provide PILT payments to counties at 80% of forecasted funding levels.

Key Goals and Measures

This budget items is submitted to help manage cost in the growing PILT program.

Statutory Change: Updates are needed from M.S. 477A.12

Change Item: Federal Conformity

Fiscal Impact ($000s)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
General Fund					
Expenditures		0	0	0	0
Revenues	$90	$(11,600)	$5,410	$4,705	$2,845
Other Fund					
Expenditures		0	0	0	0
Revenues		0	0	0	0
Net Fiscal Impact	$(90)	$11,600	$(5,410)	$(4,705)	$(2,845)

Recommendation

The Governor recommends that Minnesota law be amended to conform to most federal tax laws passed in The Heroes Earnings Assistance and Relief Tax Act of 2008, The Heartland, Habitat, Harvest, and Horticulture Act of 2008, The Housing Assistance Tax Act of 2008, and the Emergency Economic Stabilization Act of 2008.

- The Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008
  The HEART act provides tax relief and benefits for military personnel and their families, including making permanent the election to include combat pay as earned income for the purposes of the federal Earned Income Credit.

- The Heartland, Habitat, Harvest, and Horticulture Act of 2008
  This act extends agricultural and other programs. Among the provisions, the act extends the special rule for contributions of qualified conservation real property (tax years 2008 and 2009) and allows a deduction for endangered species recovery expenditures.

- The Housing Assistance Tax Act of 2008
  This act includes provisions that are intended to help with the housing crisis.

- The Emergency Economic Stabilization Act of 2008
  This act provides incentives for energy production and conservation, and extends certain expiring tax provisions, such as tax-free distributions from individual retirement plans for charitable purposes.

Certain federal provisions would have a high cost to the state if adopted. Due to the historic deficit Minnesota is currently facing, the Governor does not recommend adopting the following provisions:

- Additional standard deduction for state and local property taxes, which is estimated to cost $35.2 million in FY 2009 – FY 2010.
- Tax deduction for qualified tuition and related expenses, which is estimated to cost $26.8 million in FY 2009 – FY 2010.
- Provision to allow ordinary income treatment for gain or loss from the sale or exchange of certain preferred stock by certain financial institutions, which is estimated to cost $8 million in FY 2009 – FY 2011.
- Tax deduction for certain educator expenses, which is estimated to cost $2 million in FY 2009 – FY 2010.

Background

In Minnesota, 2.6 million individual income tax returns are filed each year. In our tax filing system, individuals are required to calculate and pay the correct amount of Minnesota individual income tax. This system only works effectively if the computation of the income tax for the vast majority of taxpayers is easy enough that the taxpayer can simply compute the correct amount of tax.

Under current Minnesota law, the starting point for computing Minnesota income tax is “federal taxable income” as defined in the Internal Revenue Code of 1986 as amended through February 2008. Technically, this means any taxpayer who has an item of income or a deduction that is changed because of post February 2008 federal changes in the code needs to recalculate their federal taxable income before they can start their Minnesota return. For taxpayers in this position, the recalculation of federal taxable income may be a difficult task even with the help of a tax professional.

In general, it has been the position of past administrations and past legislatures to conform to the federal tax code as soon as possible and to the maximum extent possible. Keeping the Minnesota system aligned is often called "federal conformity." Federal conformity is not automatic. The legislature is required to act to incorporate new federal changes into Minnesota tax laws. The Governor's proposal adopts most of the current code and eliminates the need for taxpayers to recalculate their federal taxable income.

Relationship to Base Budget

This proposal carries a revenue gain in FY 2009 of $90,000 and a revenue loss in FY 2010 of $11.6 million. In FY 2011 – FY 2013, the proposal would result in revenue gains to the general fund.

Statutory Change: M.S. 289A.02, 290.01, 290.03, and 291.005

Change Item: Education Aid Payments Shift

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$(6,797)	$147	$111	$103
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(6,797)	$147	$111	$103

Recommendation

The Governor recommends that the payment schedule for state aids and property tax credits paid to school districts and charter schools on a 90% current, 10% final adjustment basis be changed to an 80% current, 20% final adjustment basis beginning in FY 2010. This would result in a total reduction of state expenditures of $683.2 million in FY 2010, $9.477 million in FY 2011, $10.712 million in FY 2012, and $12.892 million in FY 2013. The amounts detailed in the chart above include only the changes to property tax credits paid to school districts. The K-12 aid payment reductions are reflected in the Minnesota Department of Education portion of the budget document.

Background

The aid payment percentage refers to the amount of the entitlement that will be paid out in the "current year" and the "final year." Under current law, for programs that are subject to the aid payment shift, 90% of the entitlement is paid to school districts in the "current year" and 10% is paid out in a final adjustment payment in the "final year." The final adjustment payment must include the amounts necessary to pay a district's full aid entitlement for the prior year based on actual data when actual data is available.

This proposal would change the percentage in the "current year" to 80% and the payment in the "final year" to 20%. Because school districts operate on an accrual basis rather than a cash basis, the reduction in cash paid during the school year allows the district to recognize the same level of revenue while allowing the state (operating on a cash basis) to defer the cost to the next fiscal year.

School districts have authority to borrow for a period of up to 13 months against receivable state aid, federal flow-through aid and local tax receipts, and to participate in a state credit enhancement plan that allows districts to qualify for the best interest rates with state guarantee of payment in the event of district default under M.S. 126C.50-56. For FY 2009, approximately 90 districts borrowed in anticipation of state and federal aid. The number of districts choosing to access additional cash by borrowing against taxes receivable is unknown at this time as the process begins in January and February after final certification of school district tax levies.

Fiscal Impact by Budget Activity Level ($000s)	**FY2010**	**FY2011**	**FY2012**	**FY2013**
Disaster Credit	$(3)	$3	$0	$0
Disparity Reduction	(858)	0	0	0
Border City	(100)	(5)	(5)	(6)
PY Real Property	(22)	0	0	0
Homestead Market Value	(5,172)	149	116	109
Agricultural Land Market Value	(588)	0	0	0
Mobile Home Homestead Market Value	(54)	0	0	0
Total Credit Payment Delay	**$(6,797)**	**$147**	**$111**	**$103**

Key Goals and Measures

Districts will not experience revenue loss as a result of the payment shift.

Statutory Change: M.S. 127A.45

Change Item: Property Tax Refund and Income Tax Interaction

Fiscal Impact ($000s)	FY 2010	FY 2011	FY 2012	FY 2013
General Fund				
Expenditures	$0	$11,970	$9,800	$9,690
Revenues	0	(12,600)	(10,600)	(10,500)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$0	$24,570	$20,400	$20,190

Recommendation

The Governor's budget recommendations for reductions in Local Government Aid, County Program Aid, Residential and Agricultural Market Value Credit and school levy changes interact with the property tax refund claims and the income tax system. The result is an increase in property tax refunds paid directly to homeowners and an increase in deductions on individual and corporate tax forms.

Background

The Governor's proposed budget changes affect several property tax aid and levy programs. It is assumed that some of these aid reductions to local governments will result in levy increases that will increase property taxes. The property tax increases will raise the amount of property tax refunds to homeowners. The property tax increases will also increase the deductions on individual and corporate tax forms, thereby decreasing income taxes paid.

The homeowner's property tax refund (PTR) program is a state-paid refund that provides direct tax relief to homeowners from the general fund. The PTR is paid to homeowners whose property taxes are high relative to their incomes. If property tax exceeds a threshold percentage of income, the refund equals a percentage of tax over the threshold up to a maximum amount. In 2008, the maximum refund was increased to $2,310. Homeowners without dependents whose income exceeds $96,939 are not eligible for a refund.

Relationship to Base Budget

This will result in both reduced revenue coming into the general fund through income taxes and an increase in general fund expenditures through the property tax refund payments to homeowners.

Statutory Change: Not Applicable