Tax Expenditure Review Commission: Tax Expenditure Objective Review October 11, 2022

Updated on August 9, 2024, to reflect law changes enacted in 2023 and 2024.

Initial reviews for Employer Transit Pass Credit (1.87 and 2.28) and Solar Energy Systems (4.27) are not included in this version as they were reviewed by the Tax Expenditure Review Commission in 2024.

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STATE OF MINNESOTA
Legislative Budget Office

Introduction

Per Minnesota statue 3.8855, subdivision 4, paragraph (a), the Tax Expenditure Review Commission must complete an initial review of the state's tax expenditures and identify the purpose of each of the state's tax expenditures, if none was identified in the enacting legislation. Under the direction of the Tax Expenditure Review Commission, tax expenditure objectives are prepared for consideration of the commission. This briefing provides an initial review for a selection of tax expenditures and presents potential tax expenditure objectives. Commission members may choose to adopt, modify, or reject the objectives presented in this briefing.

The objectives presented here are informed by a review of the Minnesota legislative record pertaining to each enacted provision, adopted objectives of comparable legislation in other states, and academic and industry consensus. Reference sources are provided for each provision.

The initial review of tax expenditures is focused on identification of objectives; however, methods for evaluating the effectiveness of an expenditure and potential metrics are also suggested. The ability to perform such evaluations and produce such metrics may be limited by the data available at the time a full analysis is conducted.

This briefing is prepared by the Legislative Budget Office for the Tax Expenditure Review Commission. The tax expenditure description, projections of fiscal impact by fiscal year, and reference number for each tax expenditure provision are adopted from the 2022 Tax Expenditure Budget report (TEB) prepared by the Department of Revenue (DOR). As stated in the preface of the published 2022 TEB report, the projections of fiscal impact reflect Minnesota law after changes enacted in the 2021 Legislative Session. Figures for the most recent estimate of claims and state fiscal impact are provided by DOR. This report was drafted with input from non-partisan legislative fiscal and research staff and the DOR Tax Research Division.

For more information on the Tax Expenditure Review Commission please visit the Legislative Budget Office website [https://www.lbo.leg.mn/]

Methodology

This section provides a general overview of the research process taken to identify the proposed tax expenditure objectives and potential metrics for measurement of effectiveness. This research process was designed in consultation with the Minnesota Legislative Reference Library.

The primary source of reference in determining a tax expenditure objective is the enacting legislation for each respective tax expenditure provision. A review of the enacting law and previous engrossments is performed for each tax expenditure to identify an author's reference to the legislation's intent. Additionally, previous committee meetings, floor debates, and meeting minutes are reviewed to ensure a comprehensive assessment. Beyond the enacting legislation and any prior engrossments, previously introduced bills with comparable language are reviewed in the same manner as previously described.

Comparable tax programs across peer states are referenced in cases where a tax expenditure's objective cannot be identified explicitly in the Minnesota legislative record. Components of policy design are considered to ensure appropriate comparisons can be made to programs in other states. Such considerations include intended beneficiary, tax type, and provision type as referenced in the TEB report. The two main resources used to identify such programs include the National Conference of State Legislatures' State Tax Incentive Evaluations Database and the Institute on Taxation and Economic Policy's State-by-State Tax Expenditure Reports.

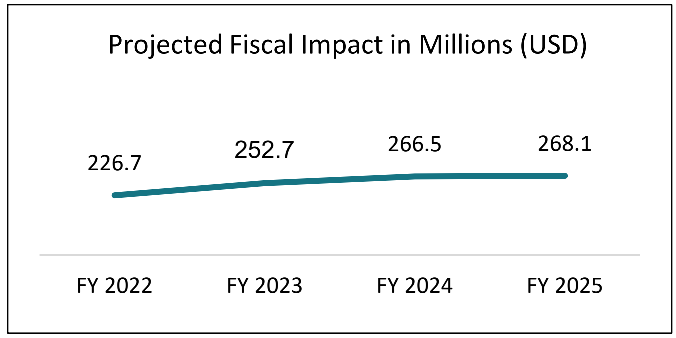
A literature review is performed to gauge the academic and industry consensus regarding the objectives for specific tax policy in cases where an objective cannot be identified by the two methods described above. Additionally, these sources are referenced to identify potential metrics to measure effectiveness and impact. More detail to these findings can be found in each respective provision briefing.

Working Family Credit

Tax Expenditure Initial Review - TEB 1.90

Tax Expenditure Facts

Year Enacted	1991
Statute	Minn. Stat § 290.0671
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	$227,191,168 - Tax Year 2020
Latest Claims Estimate	371,570 - Tax Year 2020
Expiration Date	None



Tax Expenditure Description

The Minnesota working family credit is a refundable credit against the individual income tax allowed to taxpayers who are eligible for the federal earned income credit. To qualify, the taxpayer (or spouse) must have income from wages or self-employment. A taxpayer is not eligible if investment income exceeds a specified amount ($11,000 for tax year 2023). Although the Minnesota working family credit generally uses the same eligibility requirements and definitions as the federal earned income credit, except for income limits and the required use of a social security number, the calculation of the state credit is separate.[*]

Additional Background Information

This tax credit is administered by the Department of Revenue. Beneficiaries of this tax expenditure are individuals residing in Minnesota. A part-year resident can apply for a partial credit according to rates specified in law.[1] The state fund impacted by this tax expenditure is the state General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the working family credit is to encourage work and help families raise their income above the poverty guideline levels.

Sources

The proposed tax expenditure objective is adopted from A Review of Selected Tax Expenditures by the Minnesota House Research Department in 2013.[2]

Other Considerations Regarding the Proposed Tax Expenditure Objective

Minnesota House Research cited the same proposed tax expenditure objective in its 2016 report, the Federal Earned Income Tax Credit and the Minnesota Working Family Credit, and in its 2022 report, the Working Family Credit and Federal Earned Income Credit.[3],[4]

[*] The description from the 2022 Tax Expenditure Budget published by DOR has been updated by the LBO to account for law changes since the original publication of this document.

Descriptions to the intent of this tax credit in committee by legislative members align with the proposed tax expenditure objective.[5]

The proposed objective is also reconciled on the federal level. The report published by House Committee on Budget of US Congress, The Earned Income Tax Credit Boosts Work, Reduces Poverty, and Provides Other Benefits for Working Americans, shared the similar objective.[6] Numerous academic studies and evaluations by other States also collaborated with the proposed sentiment.

Potential Metrics and Performance Measures

The commission can consider an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across income, demographic characteristics (family size, family type), and geography.

Another potential metric is to examine how the poverty level and labor participation rate evolved over time in relation to the participation rate of working family credit recipients.

Economic modelling can be applied to study the short term and long term economic and fiscal impacts of the working family credit.

Contact Information and Disclaimer

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[1] Minnesota Statutes 2021, section 290.06 subdivision 2c(e)

[2] Dalton, P, Manzi, N and J, Michael. (2013). *A Review of Selected Tax Expenditures*. St. Paul: Research Department of the Minnesota House of Representatives

[3] Manzi, N and J, Michael. (2016). *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*. St. Paul: Minnesota House of Representatives Research Department

[4] Williams, Sean. (2022). *The Working Family Credit and Federal Earned Income Credit*. St. Paul: Minnesota House of Representatives Research Department

[5] Minn. House. Hearing on H.F. 516 before the House Tax Committee on Taxes, 90th Minn. Leg., Reg. Sess. (Feb. 19, 2017), available at: https://www.house.leg.state.mn.us/hjvid/90/889769 (video)

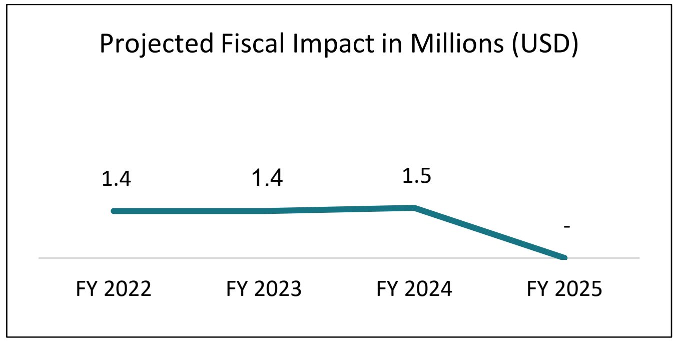
[6] Yarmuth, J (2018). *The Earned Income Tax Credit Boosts Work, Reduces Poverty, and Provides Other Benefits for Working Americans*. Washington DC: Committee on the Budget of U.S. House of Representatives

Beginning Farmer Management Credit

Tax Expenditure Initial Review - TEB 1.103

Tax Expenditure Facts

Year Enacted	2017
Statute	Minn. Stat. § 290.06, Subd.38
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	$472,457 - Tax Year 2020
Latest Claims Estimate	382 - Tax Year 2020
Expiration Date	2030



Tax Expenditure Description

A beginning farmer may claim a nonrefundable credit for participating in a financial management program approved and certified by the Minnesota Rural Finance Authority. The credit is equal to the cost of participating in the program, up to $1,500 per year. The credit may be taken for up to three years while the farmer is in the program. Any unused credit may be carried forward for up to three years. The credit was enacted in 2017 and will expire after 2030. Approximately 370 returns claimed this credit in tax year 2020.

Additional Background Information

This tax expenditure is administered by Rural Finance Authority. Beneficiaries of this tax expenditure are the beginning farmers residing in Minnesota. The state fund impacted by this expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer management credit is to incentivize beginning farmers to participate in a financial management program approved by the Rural Finance Authority to improve the farming operation success rate in the state of Minnesota.

Sources

The proposed tax expenditure objective was informed by the relationship of the beginning farmer management credit to the beginning farmer incentive credit. Further, a review of academic literature suggests that improved business planning[7] and financial management programs[8] result in higher profitability and financial efficiency for beginning farmers. The logic implied by these studies informs the drafting of the proposed tax expenditure objective, assuming this aligns with the intention of the legislature.

Potential Metrics and Performance Measures

A possible metric for Minnesota's Beginning Farmer Management Credit includes an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across demographics of beginning farmers, experience levels, and locations.

An effectiveness study can be conducted to examine whether participation in financial management programs selected by the Rural Finance Authority led to the successful operations of beginning farmers.

An analysis of registration enrollment for financial management programs approved by the Rural Finance Authority can be performed to gauge whether this incentive has increased participation in the education programs.

Nebraska requires financial management education programs for beginning farmers applying for a beginning farmer tax credit. An evaluation of that program by the state's Legislative Auditor reports on the number of claims submitted and the total dollar value of approved claims[9]. As participation in the financial management program is required to qualify for the larger Beginning Farmer Tax Credit, it is difficult to assess whether enrollment rates in the education program are impacted by the financial management program credit.

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[7] Mishra, A., Wilson, C., & Williams, R (2009). Factors affecting financial performance of new and beginning farmers. Agricultural Finance Review, Vol. 69 pages 160-179

[8] Katchova, A.L. and R. Dinterman. (2018). Evaluating Financial Stress and Performance of Beginning Farmers during the Agricultural Downturn. Agricultural Finance Review, Vol.78

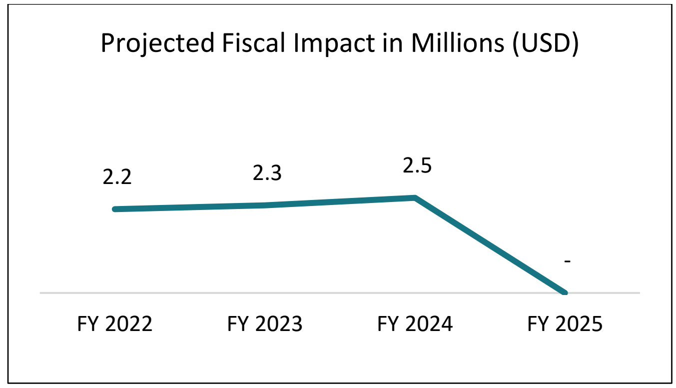
[9] Office of the Legislative Auditor (2018) The Beginning Farmer Tax Credit Act: Performance on Selected Metrics. Lincoln. Performance Audit Committee – Nebraska Legislature.

Beginning Farmer Incentive Credit

Proposed Tax Expenditure Objective Review - TEB 1.104

Tax Expenditure Facts

Year Enacted	2017
Statute	Minn. Stat § 290.06, Subd. 37 and 41B.0391
Tax Type	Individual Income Tax
Provision Type	Credit
Latest Fiscal Impact Estimate	$2,454,443 – Tax Year 2020
Latest Claims Estimate	620 – Tax Year 2020
Expiration Date	2030



Tax Expenditure Description

A nonrefundable credit is available to taxpayers who sell or rent agricultural assets to a beginning farmer. The credit equals one of the following:

- 8% of the sale price or market value of the asset, up to $50,000.
- 10% of the gross rental income in each of the first three years of a rental agreement, up to $7,000 per year; or
- 15% of the cash equivalent of the gross rental income in each of the first three years of a rent-share agreement, up to $10,000 per year.

Any unused credit may be carried forward for up to 15 years. The total value of credits is capped at $6.5 million for 2023 and $4 million in later years. The credit was enacted in 2017 and will expire after 2030.

Additional Background Information

This tax expenditure is administered by Rural Finance Authority. Beneficiaries of this tax expenditure are asset owners residing in Minnesota, including individual farmers, "pass through" entities, and partnerships. A nonresident or part-year resident can apply for a portion of the credit, using the percentage calculated in section 290.06, subdivision 2c, paragraph (e). The state fund impacted by this tax expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of the beginning farmer incentive credit is to lower the barrier of entry for a beginning farmer and make them more financially competitive.

Sources

The objective is described in testimony of HF608 by the bill's author, Representative Nels Pierson, before the twenty-sixth meeting of the House Tax Committee during 2017-2018 session.

Other Considerations Regarding Proposed Tax Expenditure Objective

Nebraska enacted a Beginning Farmer Tax Credit Act[10] in 1999, preceding Minnesota's program. The intent of Nebraska's legislation is described in the enacting language and coincides with the proposed tax expenditure objective proposed in this review. In addition, evaluation studies published by the Iowa Department of Revenue in 2015[11] and 2020[12] provided a comparable rationale for the objectives of a beginning farmer tax credit.

Potential Metrics and Performance Measures

Evaluations of similar tax credits include an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the demographics across different asset owners, asset types, and locations. The 2020 Iowa Department of Revenue evaluation of a similar tax expenditure compared outcomes of participants in the beginning farmer program to outcomes for beginning farmers who did not participate in the tax credit program. The Iowa study evaluated outcomes across three measures:

- Farm income
- Ratio of farm expenses to net income'
- Continued engagement in farming

Evaluations of the credit could also center around survey data of program participants to determine the level of which the landowner was influenced to sell or rent their land to a beginning farmer based on the financial incentive received from the tax credit.

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[10] (1999) State of Nebraska Legislative Bill 630

[11] Girardi, A. (2015). *Beginning Farmer Tax Credit Program Tax Credit Program Evaluation Study*. State of Iowa: Tax Research and Program Analysis Section Iowa Department of Revenue.

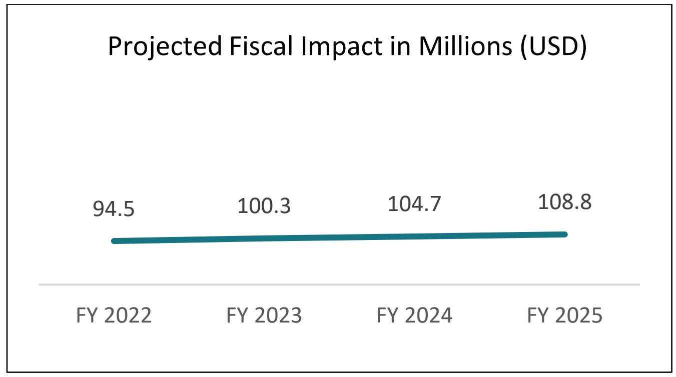
[12] Montgomery, E. (2020). *Beginning Farmer Tax Credit Program Tax Credits Program Evaluation Study*. State of Iowa: Tax Research and Program Analysis Section Iowa Department of Revenue.

Research and Development Credit

Tax Expenditure Initial Review - TEB 1.86 and 2.27

Tax Expenditure Facts

Year Enacted	1981
Statute	Minn. Stat. Section 290.068
Tax Type	Corporate Franchise Tax Credit, Individual Income Tax Credit
Provision Type	Credit
Latest Fiscal Impact Estimate	$56,359 -Tax Year 2019
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None



Tax Expenditure Description

Minnesota allows businesses conducting research and development within Minnesota to claim a nonrefundable credits against their corporate franchise taxes or individual income taxes (for pass-through tax entities, such as LLCs and S corporations). Expenditures include wages, costs of supplies, computer costs, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

The tax credit is based on the excess of current-year research expenditures over a calculated base amount, but in most cases 50% of current-year research expenditures are eligible for the credit. The credit is 10% of the first $2 million of eligible expenditures and 4% of the excess over $2 million. Any credit that exceeds liability can be carried forward up to fifteen years.

Additional Background Information

This tax expenditure is structured in line with the federal R&D credit in Section 41 of the Internal Revenue Code[13].

This tax expenditure is administered by the Department of Revenue. Beneficiaries of this tax expenditures are Individual taxpayers and Corporate. The state fund impacted by this tax expenditure is the State General Fund.

Proposed Tax Expenditure Objective for Consideration

The objective of Research and Development Credit is to create or retain jobs, increase research activity, and attract or retain business in Minnesota

Sources

The Office of Legislative Auditor proposed the above statement as individual purposes in its 2017 Minnesota Research Tax Credit Evaluation Report[14]. The report was part of an evaluation of economic development incentive programs required by Minnesota session law[15].

Other Considerations Regarding the Proposed Tax Expenditure Objective

The proposed objective is in line with the policy intents offered by Congressional Research Services of US Congress in their 2022 report, Federal Research Tax Credit: Current Law and Policy Issues[16].

The Minnesota House Research Department states that the R&D credit serves an "economic development" purpose in its 2017 publishing, Short Subjects: Minnesota Research and Development Tax Credit[17].

The Federal R&D credit was enacted in 1981 and Minnesota was the first state to follow suit. The background of economic conditions during the early 1980's linked the rationale of the R&D credit to the economic theory of the Cobb-Douglas production Model[18]. One implication of the model is that innovation is the engine for growth[19]. Numerous academic studies reviewed by the LBO imply the same sentiment. Therefore, another potential purpose for the tax credit is to support innovation across industries in Minnesota.

Potential Metrics and Performance Measures

A possible metric for this tax expenditure includes an incidence analysis to understand the distribution of beneficiaries throughout the state, studying the variance across organizations of varying sizes, and industry.

Another potential metric is a Benefit-to-Cost Ratio, a comparison of the total R&D spending attributable to the credit's total revenue loss.

An effectiveness study can be conducted to examine whether a business entity is more likely to conduct R&D in Minnesota after taking the R&D credit into consideration.

Economic modelling can be applied to study the short term and long term economic and fiscal impacts of the tax credit.

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[13] 26 U.S.C. § 41

[14] Office of the Legislative Auditor. (2017). *Minnesota Research Tax Credit*. St. Paul: State of Minnesota

[15] Laws of Minnesota 2015, chapter 77, article 2, section 1, subdivision 2.

[16] Guenther, G. (2022). *Federal Research Tax Credit: Current Law and Policy Issues.*Washington D.C.: Congressional Research Service.

[17] Michael, J. (2017). *Short Subjects: Minnesota Research and Development Tax Credit*. St. Paul: Research Department of the Minnesota House of Representatives

[18] Aghion, Durlauf, Aghion, Philippe, Durlauf, Steven N, & ScienceDirect. (2005). *Handbook of economic growth. Volume 1B* (1st ed., Handbooks in economics bk. 22). Amsterdam: Elsevier.

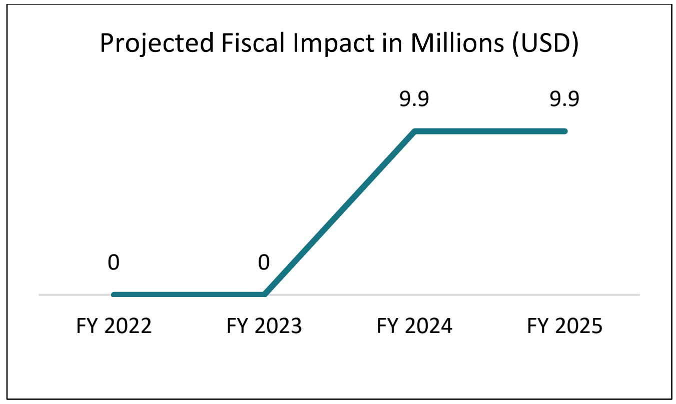
[19] Verba, M. (2019). *Growth and Innovation in the presence of Knowledge and R&D accumulation Dynamics*. Economics of Innovation and New Technology

Housing Contribution Credit

Tax Expenditure Initial Review - TEB 1.97, 2.32, and 12.09

Tax Expenditure Facts

Year Enacted	2021
Statute	Minn. Stat. § 290.0683; 462A.40; 297I.20
Tax Type	Individual Income, Corporate Franchise, Insurance Premiums
Provision Type	Nonrefundable Credit
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	December 31, 2028



Tax Expenditure Description

A nonrefundable credit is allowed for contributions to a designated account in the Housing Development Fund administered by the Minnesota Housing Finance Agency (MHFA). The account is to be used for grants and loans for low and moderate-income housing developments.

The credit is equal to 85% of contributions of at least $1,000 but not more than $2 million. Any unused credit may be carried over for up to 10 years. Total credits are limited to $9.9 million in each year. The credit was enacted in 2021 and is effective for tax years 2023 through 2028.

Note: The estimates shown on the graph are the total projected credits to be claimed against the corporate franchise tax, the individual income tax, and the insurance premiums tax.

Additional Background Information

An individual or business that contributes to the Minnesota Housing Tax Credit Contribution Account can reduce their income, franchise, or insurance premium tax liability by up to 85 percent of the contribution amount. The taxpayer may indicate that a contribution is intended for a specific qualified project.[20]

This expenditure reduces the amount of income tax that is collected. Income tax revenue is deposited in the state General Fund as provided by Minn. Stat. 290.62.

MS 462A.40, subd. 5 requires the MHFA to submit a report by January 15 of each year on the tax credits and financing provided in the previous fiscal year.

Proposed Tax Expenditure Objective for Consideration

The objective of the Minnesota Housing Tax Credit (Minn. Stat. 290.0683) is to increase the development and availability of affordable housing to persons and families of low and moderate incomes in Minnesota.

Sources

This statement was taken from companion bills SF 1866 and HF1971, as introduced (2021). Bill sections one through three are functionally identical to the language that was ultimately enacted in Laws 2021 and codified in statute. Section four of SF 1866 / HF1971 includes the statement shown above and indicates that the statement is intended to fulfill the requirements of MS 3.192 (Requirements for New or Renewed Tax Expenditures). Although there are some technical differences between SF 1866 / HF1971 and statute such as contribution thresholds, the credit is structured the same.

In addition, bill authors emphasized at Tax Committee hearings for SF 1866 and HF 1971 that the proposed legislation was intended to address a shortage of affordable housing in Minnesota.[21]

Other Considerations Regarding Proposed Tax Expenditure Objective

- Bills introduced in 2019 (HF1156/SF404) and 2018 (HF4072/SF3301) contain language similar to SF 1866 and current statute, including objectives that are identical to the statement shown above.
- Bill author testimony for SF 1866 and HF 1971 indicates that bill language was modeled after the North Dakota Housing Incentive Fund Tax Credit. This incentive was created in 2011 to help address an affordable housing shortage in western North Dakota.
- This credit was enacted in Laws 2021, First Special Session. A statement of intent was not included in Laws 2021 or the corresponding omnibus bill.[22]
- Other states that offer housing tax credits generally do so in order to encourage the development of affordable housing. For example, the stated purpose of the recently passed Kansas Housing Investor Tax Credit Act is to “bring housing investment dollars to communities lacking adequate housing”.[23]

Potential Metrics and Performance Measures

MS 462A.40, subd. 5 requires the MHFA to provide a report by January 15 of each year that includes “a breakdown of the tax credits, grants, and loans by region of the state. The report shall also include information on planned financing in the current fiscal year.” Staff anticipate using MHFA report data along with other state/federal data to compare the historical rate of affordable housing development in Minnesota with the rate of development after the tax credit has been effective for three or more years, particularly the development of housing units that meet the criteria specified in MS 462A.40, subd. 2. A performance review could also compare geographical housing needs with the locations of tax credit supported development, depending on the availability of demographic and survey data – is the credit improving the allocation of affordable housing?

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[20] MS 462A.40, Subd. 2-3 define what funds deposited in the Minnesota Housing Tax Credit Contribution Account can be used for. https://www.revisor.mn.gov/statutes/cite/462A.40#stat.462A.40.2.

[21] Senate Tax Committee hearing, March 23, 2021. SF 1866 is discussed at 21:50 of the audio, available at www.senate.mn or the following direct link. House Tax Committee hearing, March 25, 2021. HF 1971 is discussed at 1:15 of the audio, available at www.house.leg.state.mn.us or the following direct link.

[22] See Minnesota Laws 2021, First Special Session chapter 14, article 1, sections 13, 15, and 16.

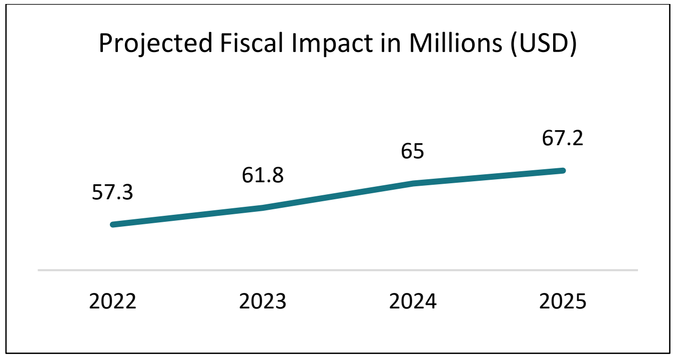
[23] Summary of Kansas HB 2237, available online at http://www.kslegislature.org/li/b2021_22/measures/documents/summary_hb_2237_2022.

Telecommunications Equipment

Tax Expenditure Initial Review - TEB 4.21

Tax Expenditure Facts

Year Enacted	2001
Statute	MS Section 297A.68, Subd. 35a
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	None



Tax Expenditure Description

An exemption from the sales and use tax is allowed for telecommunications, cable television, and direct satellite equipment purchased or leased for use directly by a telecommunications, cable television, or direct satellite service provider in providing telecommunications services that are ultimately sold at retail. The exemption applies regardless of whether purchases are made by the owner, a contractor, or a subcontractor.

The exemption includes machinery, equipment, and fixtures used in receiving, initiating, amplifying, processing, transmitting, retransmitting, recording, switching, or monitoring telecommunications services. It also includes repair and replacement parts and accessories for qualifying equipment. The exemption does not include wire, cable, or poles.

This exemption was enacted in 2001. In 2013, the exemption was repealed, effective July 1, 2013. In 2014, the exemption was reinstated, effective April 1, 2014. The exemption was expanded to include fiber and conduit in 2017.

Additional Background Information

This tax expenditure provides a specific economic benefit to telecommunications and pay television service providers.

An internet service provider does not provide telecommunications or pay television service as defined in MS 297A.61, Subd. 24-25 and therefore cannot purchase equipment exempt from the sales tax. When machinery and equipment is purchased that can be used in providing internet service as well as telecommunications and pay television services, the exemption applies only if the taxpayer can document that the machinery and equipment will be used principally in the providing of telecommunications or pay television services.[24]

The Minnesota Department of Revenue administers the sales and use tax. A purchaser must provide a completed certificate of exemption to the seller in order to claim the exemption.

This tax expenditure reduces the amount of sales tax that is collected. Sales tax revenue is deposited in the state General Fund except as provided by MS 297A.94.

Proposed Tax Expenditure Objectives for Consideration

The tax expenditure objective of the Telecommunications Equipment Exemption (MS 297A.68, subd. 35a) is to reduce potential tax pyramiding and promote transparency in the tax system by exempting telecommunications equipment that is used to provide taxable telecommunications services.

The tax expenditure objective of the 2017 amendment to the Telecommunications Equipment Exemption (MS297A.68, subd. 35a) that expanded the definition of "telecommunications or pay television machinery and equipment" to include fiber and conduit is to increase the deployment and accessibility of broadband internet service in Minnesota.

Sources

The tax expenditure objective statement for the general exemption is based on testimony from House and Senate Tax Committee hearings for companion bills HF2023 and SF1819, which were ultimately included in the 2001 tax omnibus bill HF 1.[25]

The proposed tax expenditure objective statement for the 2017 amendment is based on author testimony from House and Senate Tax Committee hearings for companion bills SF 955 and HF1250, which were ultimately included in the 2017 omnibus tax bill HF 1.[26]

Other Considerations Regarding the Proposed Tax Expenditure Objective

The legislature created a working group in 1997 to study the taxation of telecommunications services. The final report published in 1999 provided eight recommendations, including a sales tax exemption for telecommunication equipment used in providing taxable telecommunication services. The report contended that an exemption would (a) reduce potential tax pyramiding, (b) better align the Minnesota sales tax with the economic definition of a consumption tax, and (c) "send a welcoming message to telecommunication firms looking to locate in this state".[27]

Potential Metrics and Performance Measures

Staff anticipate that a qualitative assessment will be needed to determine if the tax expenditure is meeting its objective. This type of analysis may include an overview of consumption tax policy principles, the differences between a sales tax and gross receipts tax, the effects of potential tax pyramiding (such as changes in market behavior, embedded taxes, and cross-border effects), and the extent to which this expenditure helps align statutory sales tax rates with effective sales tax rates, if measurable.

An administrative and technical review may also be necessary based on the stated objective of the 2017 amendment referenced above. If the intent of the amendment was to expand broadband internet access, then the expenditure may need to be clarified to ensure that the exemption of fiber and conduit applies to internet service providers as well as telecommunications and pay television providers. Note that companion bills SF 3480 and HF 4422 introduced during the 2022 session proposed to specifically exempt fiber and conduit purchases made by a broadband or internet service provider, but the bill was not enacted.

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[24] See Revenue Notice #2-14 available at the Minnesota Department of Revenue website, https://www.revenue.state.mn.us/revenue-notice/02-14-sales-and-use-tax-exemption-purchases-telecommunications-equipment-internet.

[25] House Sales and Income Tax Division hearing (March 29, 2001). Audio recording available at https://www.lrl.mn.gov/media/file?mtgid=821004; Senate Income and Sales Tax Budget Division hearing (April 4, 2001). Audio recording available at https://www.lrl.mn.gov/media/file?mtgid=821052.

[26] Senate Tax Committee Hearing (February 23, 2017). SF 955 is discussed at 1:40 of the audio recording, available online at https://mnsenate.granicus.com/player/clip/1339?view_id=2&redirect=true&h=07b2ceec9c0962b8b3bf8b10604fc812; House Tax Committee Hearing (February 23, 2017). HF 1250 is discussed at 43:23 of the audio recording, available online at https://www.house.leg.state.mn.us/Committees/minutes/90023/56877.

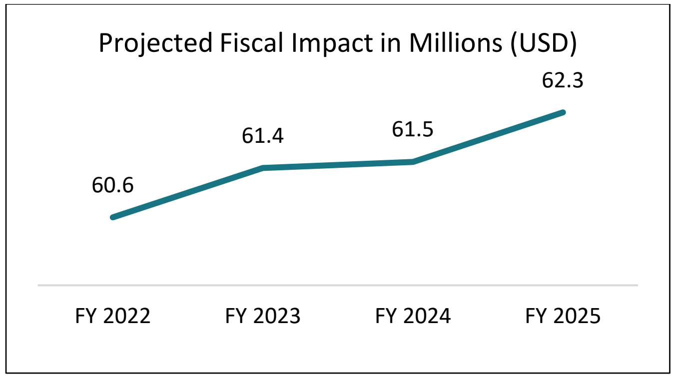
[27] Report of the Working Group on Taxation of Telecommunication Services (February 18, 1999). Available at the Minnesota Reference Library, https://www.lrl.mn.gov/.

Farm Machinery Exemption

Tax Expenditure Initial Review - TEB 4.39

Tax Expenditure Facts

Year Enacted	1981
Statute	Minn. Stat. § 297A.69, Subd. 4(1), and 297A.61, Subd. 12
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Data not available
Latest Claims Estimate	Data not available
Expiration Date	None



Tax Expenditure Description

All farm machinery is exempt from the Minnesota sales and use tax. Qualifying farm machinery includes machinery, equipment, implements, and accessories used directly and principally in the production for sale of agricultural products, including livestock. Irrigation systems also qualify for exemption.

A reduced rate for farm machinery was first enacted in 1981 at 4% when the general rate was 5%. In 1985, the rate was reduced to 2%, and in 1991 it was increased to 2.5% when the general rate was increased by 0.5%. Used farm machinery was exempted in 1994 as a temporary provision, and the exemption was made permanent in 1997. In 1998, the rate on new equipment was phased out over two years, with the full exemption effective on July 1, 2000. The definition of farm machinery eligible for exemption has been expanded several times and was last modified in 2006.

Additional Background Information

This tax expenditure provides a specific economic benefit to agricultural producers who purchase qualifying farm machinery.

The Minnesota Department of Revenue administers the sales and use tax. A purchaser must provide a completed certificate of exemption to the seller in order to claim the exemption.

This tax expenditure reduces the amount of sales tax that is collected. Sales tax revenue is deposited in the state General Fund except as provided by MS 297A.94.

Proposed Tax Expenditure Objective for Consideration

The objective of the farm machinery exemption is to reduce potential tax pyramiding and promote transparency in the tax system by exempting machinery and equipment used directly in the agricultural production of tangible personal property ultimately intended to be sold at retail.[28]

Sources

The tax expenditure objective for consideration is informed by a review of statute language including MS 297A.69 and 297A.61. Statute, originating bills, committee hearings, and available legislative documentation do not directly state a purpose for the farm machinery exemption. Staff did not find an adopted objective statement in review of similar exemptions in other states.

Other Considerations Regarding Proposed Tax Expenditure Objective

Farm machinery, replacement parts, fertilizer, and other agricultural items are commonly exempted from sales tax in other states; a recent Colorado review identified 38 states that have total or partial exemptions for farm equipment.[29] The definition of agricultural "machinery" or "equipment" varies from state-to-state, but generally the item must be used directly and principally in producing tangible personal property intended for retail sale in order to qualify, similar to the Minnesota exemption. Items that are not directly used in the production process are generally taxable, suggesting that most states offer these types of exemptions primarily to reduce tax pyramiding and increase transparency.

The Commission may also want to consider if a primary or secondary objective of this expenditure is to provide a specific economic benefit to agricultural producers, for instance to support farming operations generally or to help small farmers replace worn-out equipment.

Potential Metrics and Performance Measures

Staff anticipate that a qualitative assessment will be needed to determine if the tax expenditure is meeting its objective. This type of analysis may include an overview of consumption tax policy principles, the differences between a sales tax and gross receipts tax, the effects of tax pyramiding (such as changes in market behavior, embedded taxes, and cross-border effects), and the extent to which this expenditure helps align statutory sales tax rates with effective sales tax rates, if measurable.

Stakeholder surveys and Department of Revenue data may help inform a cost-benefit analysis. For example, survey responses to a Colorado review of farm equipment exemptions indicated that agricultural producers found the exemption "impactful for purchases of more expensive equipment, such as tractors and combines," which was balanced against forgone state and local sales tax revenue.[30]

Contact Information and Disclaimer

This tax expenditure statement review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to [Minnesota Statute 3.8855](https://www.revisor.mn.gov/statutes/cite/3.8855).

Notice: Proposed Tax Expenditure Objective statements are not binding authority and should not be used as a legal interpretation of any tax expenditure statute.

For questions regarding this review, please contact Legislative Budget Office at 651-297-7146 or lbo@lbo.mn.gov.

For information on the Tax Expenditure Review Commission, please visit https://www.lbo.mn.gov/TERC/index.html.

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[28] Tax pyramiding refers to the imposition of a sales tax at one or more stages of production and distribution before the final (retail) sale to consumers.
[29] Office of the State Auditor. (2022). Farm Equipment and Parts Exemption Evaluation Summary. Denver: State of Colorado. https://leg.colorado.gov/sites/default/files/te5_farm_equipment_parts_exemption.pdf
[30] Ibid.

Building Materials for Residences of Disabled Veterans

Tax Expenditure Initial Review - TEB 4.54

Tax Expenditure Facts

Year Enacted	1971
Statute	Minn. Stat. § 297A.71, Subd. 11
Tax Type	General Sales and Use Tax
Provision Type	Exemption
Latest Fiscal Impact Estimate	Direct measure of this estimate not available
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None

Estimated fiscal impact is less than $50,000 per year through fiscal year 2025.

Tax Expenditure Description

Building materials used to construct or remodel the residence of a disabled veteran are exempt from the sales and use tax. The exemption applies if the project is financed in whole or in part by the U.S. Government in accordance with United States Code, Title 38, Sections 2101 to 2105.

Additional Background Information

United States Code, Title 38, Sections 2101 to 2105 are administered as Specially Adapted Housing (SAH) grants and Special Home Adaptation (SHA) grants by the United States Department of Veteran's Affairs. The Minnesota Department of Revenue administers the sales tax exemption on a refund basis.[31]

Veterans with qualifying service-connected disabilities who are awarded SAH/SHA grant money to construct or modify their permanent home are eligible for the state sales tax exemption.[32] SAH and SHA grants are not subject to federal or state income taxes.[33]

This tax expenditure reduces sales tax revenues. Sales tax revenue is deposited in the state General Fund except as provided by MS 297A.94.

Proposed Tax Expenditure Objective for Consideration

The objective of the building materials exemption for residences of disabled veterans (Minn. Stat. 297A.71, subd. 11) is to provide specific sales and use tax relief to disabled veterans who have been awarded a federal grant for the construction or remodeling of their homes, ensuring that disabled veterans receive the full financial benefit of the federal program.

Sources

This statement was adapted from Washington State statute[34]. Washington offers a similar tax expenditure that includes legislative findings and a statement of intent section written into statute.

Other Considerations Regarding Proposed Tax Expenditure Objective

Enacting legislation Laws 1971 Regular Session does not include a statement of purpose. This expenditure has not been significantly modified since initial enactment.[35]

A statement of purpose was not found in applicable committee meeting minutes. Audio or other media from this time is not available.

The Veteran's Homestead Exclusion (TEB # 13.02), which also provides tax relief for disabled veterans, includes a purpose statement in statute. "The purpose of this provision of law providing a level of homestead property tax relief for veterans with a disability, their primary family caregivers, and their surviving spouses is to help ease the burdens of war for those among our state's citizens who bear those burdens most heavily." [36]

Potential Metrics and Performance Measures

Comparing the annual number or amount of refunds issued by the Minnesota Department of Revenue for qualified building material costs with the number or amount of adapted housing grants awarded by the United States Department of Veteran's Affairs to Minnesota veterans may help identify the extent to which the tax exemption is being utilized in conjunction with federal grants.

A survey among eligible population may also indicate public awareness of the tax benefit and likelihood of utilization.

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[31] Minnesota Rules 8130.6600 outlines the refund procedure for this exemption. https://www.revisor.mn.gov/rules/pdf/8130.6600/2022-06-09%2009:08:07+00:00

[32] Detailed program requirements can be found online at https://www.va.gov/housing-assistance/disability-housing-grants/ and https://www.benefits.va.gov/HOMELOANS/documents/docs/sah_handbook_for_design.pdf.

[33] See Minnesota Tax Expenditure Budget (2022) item 1.18 for more information.

[34] See Revised Code of Washington title 82 chapter 08 section 0207

[35] Minnesota Laws 1971, Chapter 124. Available online at https://www.revisor.mn.gov/laws/1971/0/Session+Law/Chapter/124/pdf/.

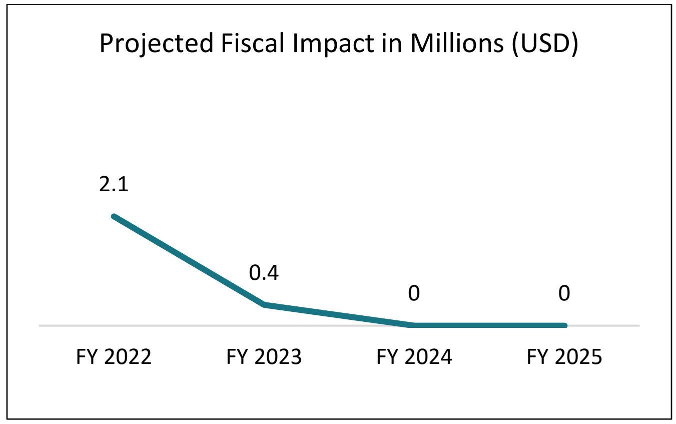
[36] Minnesota Statutes 2021, section 273.13 subdivision 34(l)

Construction Materials for Certain City Projects

Tax Expenditure Initial Review - TEB 4.73

Tax Expenditure Facts

Year Enacted	2012
Statute	Minn. Stat. § 297A.71, Subd. 44 and 297A.9905
Tax Type	General Sales and Use Tax
Provision Type	Exemption – Sales to Particular Purchasers
Latest Fiscal Impact Estimate	Direct measure of this estimate not available
Latest Claims Estimate	Direct measure of this estimate not available
Expiration Date	None



Tax Expenditure Description

Materials and supplies used or consumed in, and equipment incorporated into, the construction or improvement of a capital project of regional significance funded partially or wholly by a city of the first class are exempt. To qualify for this exemption, the project must be the construction, expansion, or renovation of a sports facility or convention or civic center and have a total construction cost of at least $40 million within a 24-month period. Funding must be drawn from the excess revenues generated by imposition of a local tax on retail sales.

Additional Background Information

Contractors engaged in eligible capital projects are direct beneficiaries of this exemption. Local municipalities are indirect beneficiaries of this exemption, assuming that qualifying sales tax exemptions are considered into lower construction bid entries for eligible projects. A reduction in sales and use tax receipts impacts the state's General Fund. The collection of sales and use tax is administered by the Department of Revenue.

Proposed Tax Expenditure Objective for Consideration

The objective of the sales tax exemption for construction materials for certain city projects is to provide an indirect means of assistance to local governments for capital projects funded wholly or partly by excess local tax revenues imposed under special law.

Sources

An explicit tax expenditure objective was not identified in the legislative record. However, an author's description to this exemption in 2017 describes the sales tax exemption as a means to help fund a city project[37]. Additionally, the state of Pennsylvania adopted a similar objective statement for a sales tax exemption on machinery and construction equipment used in a construction contract with a governmental unit including political subdivisions[38].

Other Considerations Regarding Proposed Tax Expenditure Objective

In 2017, MS § 297A.71 subd. 44 was amended to provide a sales tax exemption on construction materials, supplies, and equipment to the city of Plymouth to help fund capital improvements to the Plymouth Ice Center. During testimony before the House Tax Committee, the author of the original amendment, describes the amendment as a means of helping the city fund repairs in order to meet federal requirements for refrigerant coolants and energy systems. This language was adopted into the 2017 omnibus tax bill, where the sales tax exemption was extended to the construction of a stadium located on land which is now Allianz field in St. Paul[39].

In 2012, this exemption was included in the legislation the included the construction of the U.S. Bank Stadium. Discussion in committee hearings on that specific bill references similar tax policy applying to the development of Target Field[40].

In 2021, the Office of the State Auditor of Colorado evaluated a similar sales tax exemption which applies more generally to contractors and subcontractors performing construction services for certain tax-exempt entities. A potential objective offered for consideration was "to avoid applying sales and use taxes to contractors' purchases of construction and building materials when completing projects for tax-exempt entities.[41]"

An analysis of this expenditure should also consider a broader policy objective of attracting and stimulating economic benefits towards the geographic region where such capital projects are pursued.

Potential Metrics and Performance Measures

The following are approaches taken by other state or district offices to evaluate the effectiveness or impact of a sales tax exemption on construction and building materials.

The Office of the State Auditor of Colorado identifies a challenge in evaluating a tax incentive if a quantifiable goal is not stated by the general assembly. Thus, the office relies on a survey of eligible contractors and subcontractors that would presumably file for the tax exemption to assess likelihood of participation and awareness by eligible beneficiaries.

Connecticut's Department of Economic and Community Development reports information limited to the total amount of sales tax revenue forgone for a variety of capital projects approved on the state's behalf[42].

Washington D.C. enacted a sales tax exemption on construction materials to increase the construction and availability of supermarkets within specific wards[43]. The district intended to achieve positive externalities of increased access to nutritious foods leading to positive health outcomes for residents of those wards. A report by the district's office of Revenue Analysis indicates the sum of claims associated with the exemptions and an analysis on the construction of supermarkets in targeted areas of the district. Similar metrics of direct outcomes are repeatable in Minnesota for construction projects. The report identifies challenges in measuring externalities intended by the program.

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[37] Minn. House, Hearing on HF 924 before the House Committee on Taxes, 90th Minn. Leg. Reg. Sess. (Mar. 3, 2017), available at: https://www.house.leg.state.mn.us/hjvid/90/889866 (video)

[38] Office of the Governor. (2022. Executive Budget. Harrisburg: Commonwealth of Pennsylvania.

[39] Laws of Minnesota 2017, 1st Special Session, Chapter 1, Article 3, Section 30.

[40] Minn. Sen., Hearing on S.F. 2391 before the Sen. Comm. on Taxes, 87th Minn. Leg., Reg. Sess. (Apr. 27, 2012), available at: https://www.lrl.mn.gov/media/file?mtgid=870932 (video)

[41] Office of the State Auditor. (2021). Construction and Building Materials Exemption Evaluation Summary. Denver: State of Colorado

[42] Department of Economic and Community Development. (2019). Annual Report. New Haven: State of Connecticut

[43] Office of Revenue Analysis. (2018). Review of Economic Development Tax Expenditures. Washington D.C. Government of District of Columbia.

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