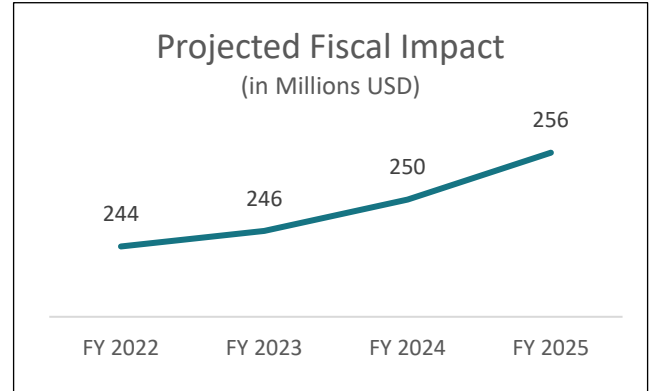


# Heating Fuel and Utility Service Exemptions

## Tax Expenditure Initial Review – TEB 4.14 - 4.16

### Tax Expenditure Facts

Years Enacted	Various – See Table 1
Statute	Minn. Stat. § 297A.67, subd. 15 and 16
Tax Type	General Sales and Use Tax
Provision Type	Exemption – Particular Goods and Services
Fiscal Impact Estimate	\$250 Million (All Exemptions) – Fiscal Year 2024
Claims Estimate	Direct measure of this estimate is not currently available.
Expiration Date	None



Note: The graph shows the combined fiscal impact of exemptions listed in Table 1.

### Tax Expenditure Description

Residential heating fuels, residential water services, and all sewer services are exempt from the sales and use tax. The following descriptions were taken from the Department of Revenue Tax Research Division 2022 Tax Expenditure Budget report.

Table 1: Heating Fuel and Utility Service Exemptions

TEB	Tax Expenditure Description	Year Enacted	Fiscal Impact FY24
4.14	An exemption from the sales and use tax applies to all fuel oil, coal, wood, steam, hot water, propane gas, and liquefied petroleum gas sold to residential customers for residential use. Purchases of natural gas by residential customers who use natural gas for their primary source of residential heat are exempt for the six billing months of November through April. Likewise, the purchase of electricity is exempt for six months for customers using electricity as the primary source of residential heat.	1978	\$135,000,000
4.15	The furnishing of water for residential use is exempt from the Minnesota sales and use tax.	1979	\$27,000,000
4.16	The furnishing of sewer services is exempt from the Minnesota sales and use tax. Sewer service has never been subject to the sales and use tax.	*	\$88,200,000

## Additional Background Information

Beneficiaries of these exemptions include residential water and sewer utility customers, commercial sewer customers, and purchasers of heating fuel for residential use.

These exemptions reduce sales tax revenue by an estimated 250 million dollars annually. Sales tax revenue is deposited in the state General Fund except as provided by Minnesota Statutes 297A.94. The Department of Revenue administers sales tax registrations, remittances, and exemptions.

### Proposed Tax Expenditure Objective for Consideration

The objective of the heating fuel and utility service exemptions is to lessen the effective tax burden of lower-income households and reduce the regressivity of the sales and use tax.

## Sources

The legislative record does not explicitly state a public policy objective for these exemptions. The proposed objective is based on Minnesota tax reform debates and the generally acknowledged rationale for exempting goods or services that could be reasonably considered basic necessities.

The Minnesota legislature debated enactment of a sales and use tax from the early 1930s until passage in 1967. Critics argued the tax was regressive and would place a disproportionate burden on low-income households.<sup>i</sup> Governor Floyd B. Olson vetoed an early attempt to enact sales tax legislation in 1935, stating that “a sales tax falls the heaviest upon those least able to pay...it must be admitted that 80 percent of the various sales taxes will be collected on the necessities of life.”<sup>ii</sup> A three percent sales and use tax was eventually enacted in the 1967 Property Tax Reform and Relief Act that included exemptions for food, prescribed drugs, and clothing, among other items.<sup>iii</sup>

States have historically exempted basic necessities – goods or services considered necessary to attain a generally accepted standard of living – to lessen the effective tax burden on lower-income households and reduce the regressivity of the sales tax.<sup>iv</sup> For the purposes of this review, it is assumed that heating fuel and utility services could be reasonably considered basic necessities.

## Potential Metrics and Performance Measures

The sales and use tax is generally described as regressive because the effective tax rate (tax paid as a percentage of income) falls as income rises.<sup>v</sup> For example, the Department of Revenue estimates that the combined effective general sales and use tax rate for the 2<sup>nd</sup> income decile of Minnesota households is 4.47 percent, while the effective rate for the highest income decile is 1.35 percent.<sup>vi</sup> A full review may assess the degree to which this exemption lowers regressivity using income data from the Minnesota Department of Revenue and consumer expenditure data from the U.S. Bureau of Labor Statistics. A full review may also compare the effectiveness of the tax expenditure with policy alternatives such as credits, rebates, or direct payments.

## Contact Information and Disclaimer

This tax expenditure review was prepared by the Legislative Budget Office for the Tax Expenditure Review Commission pursuant to Minnesota Statutes 2023, section 3.8855, subdivision 4.

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 the Legislative Budget Office at 651-297-7146 or [lbo@lbo.mn.gov](mailto:lbo@lbo.mn.gov).

For more information, please visit the [Tax Expenditure Review Commission website](#).

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<sup>i</sup> David Maeda, "Tax was a hard sell," *Session Weekly* 17, no. 6 (March 10, 2000): 22, <https://www.lrl.mn.gov/docs/pre2003/other/P615/2000/v17n6.pdf>; David Maeda, "Putting the tax before the sale," *Session Weekly* 17, no. 12 (April 21, 2000): 4, <https://www.lrl.mn.gov/docs/pre2003/other/P615/2000/v17n12.pdf>.

<sup>ii</sup> Minn. House Journal, 49th Leg., Reg. Sess. 2067-2071(1935), [https://www.leg.mn.gov/archive/vetoes/1935veto\\_HF1564.pdf](https://www.leg.mn.gov/archive/vetoes/1935veto_HF1564.pdf).

<sup>iii</sup> Laws of Minnesota 1967, 1st Spec. Sess. chapter 32, article 13, section 25, <https://www.revisor.mn.gov/laws/1967/1/Session+Law/Chapter/32/pdf/>.

<sup>iv</sup> Frederick W. Derrick and Charles E. Scott, "Sales Tax Exemptions and Credits: Time to Reevaluate," *Atlantic Economic Journal* 23, no. 4 (1995): 276. For a table of states that offer food and drug exemptions, see "State Sales Taxes – Food and Drug Exemptions," Federation of Tax Administrators, updated January 1, 2023, <https://taxadmin.memberclicks.net/assets/docs/Research/Rates/sales.pdf>.

<sup>v</sup> Stephanie Hunter McMahon, *Principles of Tax Policy* (St. Paul: West Academic, 2018), 215-216.

<sup>vi</sup> Minnesota Department of Revenue, Tax Research Division, *2021 Minnesota Tax Incidence Study: An Analysis of Minnesota's Household and Business Taxes* (October 20, 2022), 11-12, 29,32-33, <https://www.revenue.state.mn.us/sites/default/files/2023-08/2021-tax-incidence-study-post-pub-revisions-v2.pdf>.