Minnesota - Governor releases FY 14-15 budget, includes significant tax reform proposals

January 25, 2013

In brief

On January 22, 2013, Governor Mark Dayton released his fiscal year 2014-15 budget, which contains several tax reform proposals. In general, the Governor's proposal would make significant changes to the state's corporate income tax regime, sales tax laws, and other miscellaneous tax laws. [Governor's FY14-15 Budget, Released 1/22/13]

In detail

Tax reform proposals in the Governor's budget

Governor Dayton's budget includes the following:

Corporate income tax

- Reduce the corporate franchise tax rate from 9.8 percent to 8.4 percent effective January 1, 2013.
- Repeal the current law subtraction for foreign royalties and provisions for foreign operating corporations (FOCs).
- Require all sales to Minnesota of a unitary business to be included in the Minnesota sales factor (*Finnigan* Rule).
- Require business transactions to meet an economic substance test to be allowed in determining Minnesota taxable income.
- Require the distributive share of income from all domestic and foreign partnerships flow to domestic owners for purposes of calculating net income and apportionment factors of a unitary business.
- Exclude dividends received from a real estate investment trust (REIT) in calculating the deduction allowed to a corporation for dividends received from another corporation.

Sales and use tax

- Reduce the sales tax rate from 6.875 percent to 5.5 percent effective January 1, 2014.
- Broaden the sales tax base by applying the sales tax to:
  - click-through nexus sales
  - digital goods
  - remote access software
  - direct satellite services
  - business services, such as legal, accounting, architecture, specialized design, computer, management consulting, advertising, employment, and business support services
  - selected goods and consumer services, clothing items over $100, admissions and memberships, over-the-counter drugs, personal

care services and instruction, legal, accounting, auto, and other repair services.

- Repeal tax exemptions for selected items, including telecommunications equipment, court reporting documents, and advertising materials and publications.
- Convert the capital equipment sales tax refund with an upfront exemption from sales tax on the sales or lease of equipment used for manufacturing, fabrication, mining or refining. This proposed change would be effective after June 20, 2015.

Miscellaneous taxes

- Suspend the inflation adjustment for commercial/industrial property tax for taxes payable in 2014 and 2015. Beginning with taxes payable in 2016, an inflation adjustment for commercial/industrial property would resume at half the rate as current law.
- Increase the cigarette excise tax to $1.42 per pack (an increase of 94 cents per pack) and increase the tobacco excise tax to 55 percent of the wholesale price.
- Create a new 4th tier income tax bracket for upper incomes at a marginal income tax rate of 9.85 percent beginning in tax year 2013. The new rate would be applicable to taxable income above $250,000 for married joint filers. This new bracket would be adjusted yearly for inflation.

Several tax reform bills introduced in Minnesota Legislature

Minnesota convened its 88th Regular Session on January 8, 2013. Since that date, several tax reform bills have been introduced in both the House and the Senate, including:

- S.B. 8, introduced on 1/10/13, would define 'solicitor' for sales tax purposes and would impose a rebuttable presumption of nexus upon a retailer that enters into an agreement with a Minnesota resident that refers potential customers by a link on an Internet Web site, or otherwise, to the seller.
- S.B. 10, introduced on 1/10/13, would repeal the 80 percent deduction for royalties, fees, or other like income accrued or received from a foreign operation corporation or a foreign corporation which is part of the same unitary business as the receiving corporation.
- S.B. 35, introduced 1/11/13, would impose the sales and use tax on digital goods. Under the proposed legislation, 'digital goods' means sounds, images, data, facts, or information, or any combination of them, that are delivered electronically, including but not limited to, specified digital products and digital codes.
- H.B. 37, introduced on 1/10/13, would impose a 'throwback' rule for tangible personal property shipped from an office, store, warehouse, factory, or other place of storage in Minnesota and the taxpayer is not taxable in the state of the purchaser. This proposed legislation would also source receipts from the performance of services to Minnesota if the taxpayer is not taxable in the state of the purchaser and the greater proportion of the service is performed in Minnesota.

We will continue to monitor the progress of these bills.

The takeaway

For the first time in more than two decades, Democrats control the state government in Minnesota. Governor Mark Dayton is now halfway through his term and this shift in control emboldens him in his efforts to reform the Minnesota tax system. The proposal to broaden the sales tax base to include a tax on business services such as consulting and legal work indicates that this session will be contentious again. It is difficult to know what will actually pass, as there is a projected $1.1 billion deficit that must be addressed.

There are several provisions that have been repeatedly introduced in prior sessions but failed to pass that are being introduced again: repeal of the FOC, *Finnigan* sourcing, and click through nexus to name a few. These proposals bear watching, as the shift in control could make the difference.

Let's talk

If you have any questions on the Governor's budget or tax reform in Minnesota, please contact:

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