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EXTERNAL ALERT

Minnesota Governor's Proposed 2014-15 Budget Would Result in Significant Tax Law Changes

February 8, 2013

Overview

Minnesota Governor Mark Dayton recently released his proposed 2014-2015 budget.[1] The Governor's goal is a "modern tax system" that supports "a balanced budget with no one-time fixes, borrowing or gimmicks" and that is "fair for all Minnesotans."[2] If enacted, the Governor's proposed budget[3] would:

- Reduce the corporate income tax rate, while eliminating a number of subtraction modifications to the tax base.[4]
- Create a new 4th tier personal income tax bracket for high income earners.[5]
- Change Minnesota residency rules for part-year residents.[6]
- Decrease the sales tax rate, while broadening the overall tax base to include services.[7]

Many of Governor Dayton's proposals are similar to those that he proposed in 2011[8] before a stalemate with House Republicans. These proposals may be more significant this year because this is the first legislative session in over 20 years in which Democrats hold both houses of the State Legislature and the Governorship.[9]

In this Tax Alert, we highlight the more significant proposed tax law changes, including the various effective dates and the related revenue estimates.

Corporate Income Tax Proposals

Retroactive to January 1, 2013, the proposed 2014-2015 budget[10] would make the following changes to the corporate income tax (if enacted, these changes are estimated to be revenue neutral[11]):

- Reduce the corporate tax rate from 9.8% to 8.4%.[12]
- Eliminate the foreign royalty subtraction and foreign operating corporation provisions.[13]
- Require that all sales sourced to Minnesota of a unitary business be included in the sales factor numerator regardless of whether the specific unitary affiliate making the sale has nexus in Minnesota (i.e., *Finnigan* apportionment approach).[14]

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[1] *Budget for a Better Minnesota*: Governor Mark Dayton's FY 2014-15 Budget Recommendations, available at: **http://www.mmb.state.mn.us/doc/budget/bud-op/op14/gov-presentation.pdf.**
[2] *Id*. at 7.
[3] 2014-2015 Governor's Budget – Tax Aids & Credits, available at: **http://www.mmb.state.mn.us/narratives2013.**
[4] *Id*. at 6.
[5] *Id*. at 4.
[6] *Id*. at 8.
[7] *Id* at 4-5.
[8] Minnesota Biennial Budget, FY 2012-2013, State Taxes and Local Aids and Credits, February 15, 2011, available at: **http://www.mmb.state.mn.us/gov-bill-11.**
[9] Please note that the Governor's proposals are not currently included in a bill to be presented to the legislature. Any bill introduced and ultimately signed into law may be materially different from the Governor's initial proposals.
[10] 2014-2015 Governors Budget – Tax Aids & Credits**.**
[11] *Id*. at 5-6.
[12] *Id*. at 5.
[13] *Id*. at 6. See current Minnesota Statutes Section 290.01, subd. 19(d)(10).
[14] *Id*. at 6. Minnesota currently follows the *Joyce* rule – sales sourced to Minnesota are included in the sales factor numerator of a unitary business only if the specific unitary affiliate has nexus in Minnesota.

- Adopt a requirement that business transactions meet a statutory economic substance test in determining Minnesota taxable income.[15]
- Conform to the federal treatment of foreign entities under Internal Revenue Code Section 701 to include the net income and apportionment factors of foreign partnerships.[16]
- Eliminate the dividends received deduction for dividends paid by a Real Estate Investment Trust to a corporation.[17]

Personal Income Tax Proposals

Retroactive to January 1, 2013, the proposed 2014-2015 budget would make the following changes to the personal income tax (if enacted, these changes would generate estimated additional revenues in excess of $500 million per year[18]):

- Create a new 4th tier income tax bracket at a marginal rate of 9.85% (current top rate is 7.85%) for taxpayers with Minnesota taxable income above:[19]
    - $250,000 for married filing joint
    - $125,000 for married filing separate
    - $150,000 for single filers
    - $250,000 for head-of-household filers
- Extend the income tax to persons who are present in the state for more than 60 days but less than 183 days and who maintain an abode in Minnesota for at least six months. Individuals meeting these criteria would be considered “part year residents” and taxed on a pro-rata share of all income based on the number of days present in the state (in addition to continuing to be taxed on their Minnesota-sourced income).[20]

Sales and Use Tax Proposals

Effective January 1, 2014, the proposed 2014-2015 budget would make the following changes to the sales tax (if enacted, these changes would generate approximately $2.1 billion during the FY 2014-2015 biennium[21]):

- Reduce the sales and use tax rate from 6.875% to 5.5%.[22]
- Broaden the sales tax base for purchases made after January 1, 2014 to include:[23]
    - Clothing on items over $100.
    - Over-the-counter drugs.
    - Affiliate nexus sales.
    - Digital goods.
    - Remote access software.
    - Many consumer services such as accounting and legal, brokerage and investment advice, veterinary services, admissions and memberships, personal care services and instruction, and auto and other repair services.
    - Business-to-business services such as legal, accounting, architecture, specialized design, computer, management consulting, advertising, employment, and business support services.

The proposed budget would also replace the capital equipment sales tax refund with an upfront exemption. This change would be effective after June 30, 2015.[24]

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15 *Id*.
16 *Id*.
17 *Id*.
18 *Id*. at 4.
19 *Id*.
20 *Id* at 8.
21 *Id*. at 4.
22 *Id*. at 5.
23 *Id*. at 4.
24 *Id*. at 5.

Contacts

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