Overview of Income, Corporate Franchise, Sales, and Other Taxes

Background Information for Members of the House Committee on Taxes

January 2025

by

Sean Williams
Christopher Kleman
Alexandra Haigler

House Research Department

and

Cynthia Templin

Fiscal Analysis Department

Minnesota House of Representatives

Contents

State Taxes 3
The Individual Income Tax 7
Sales Taxes 27
Local Sales Taxes 36
The Corporate Franchise Tax 39
Cigarette and Tobacco Tax and Fees 48
Alcoholic Beverage Excise Taxes 50
Cannabis Gross Receipts Tax 52
Lawful Gambling Tax 53
Motor Vehicle Sales Tax 54
Motor Vehicle Fuels Tax 55
Motor Vehicle Registration Tax 57
The Provider Tax 58
Insurance Premiums Tax 59
Mortgage Registry Tax 60
Deed Transfer Tax 61
Estate Tax 62

State Taxes

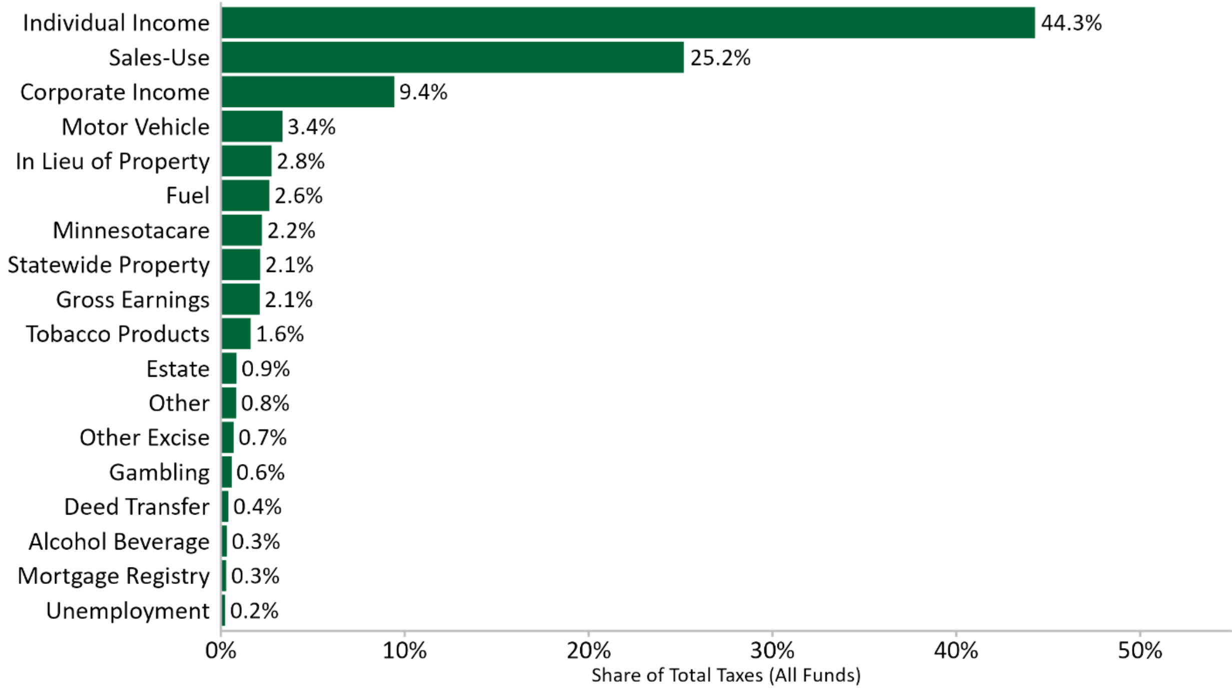
Minnesota State Tax Collections
$33.6 Billion in Fiscal Year 2024

Tax Type	FY 24 Revenue (Million $)
Individual Income	14,873
Sales-Use	8,455
Corporate Income	3,171
Motor Vehicle	1,129
In Lieu of Property	925
Fuel	887
MinnesotaCare	751
Statewide Property	718
Gross Earnings	709
Tobacco Products	544
Estate	286
Other	281
Other Excise	235
Gambling	198
Deed Transfer	139
Alcohol Beverage	111
Mortgage Registry	97
Unemployment	77

Table by House Research.
Data compiled from Minnesota Management and Budget, November 2024 Consolidated Fund Statement, Health Care Access Fund Detail, and Fund Balance Analysis Detail.

Most state taxes are credited to the general fund. Some, however, are dedicated in whole or in part to other funds. For example, the Motor Vehicle Fuels tax is constitutionally dedicated to the Highway User Trust Fund. The data shown here lists the full amount of projected collections for all state taxes in fiscal year 2024, including those that do not go to the general fund.

Individual income and sales are by far the largest state taxes



Incidence of state taxes

One way to compare different taxes is by their incidence. Tax incidence is a way of describing how the burden of a tax falls across the income distribution. Economists classify taxes as proportional, regressive, or progressive, depending on the effective tax rates paid at different income levels. The **effective tax rate** is the amount of tax paid by a group or individual, divided by that group or individual's income.

A **proportional tax** is a tax where the effective tax rate is the same across the income spectrum—taxpayers pay the same portion of their income in tax across the income spectrum.

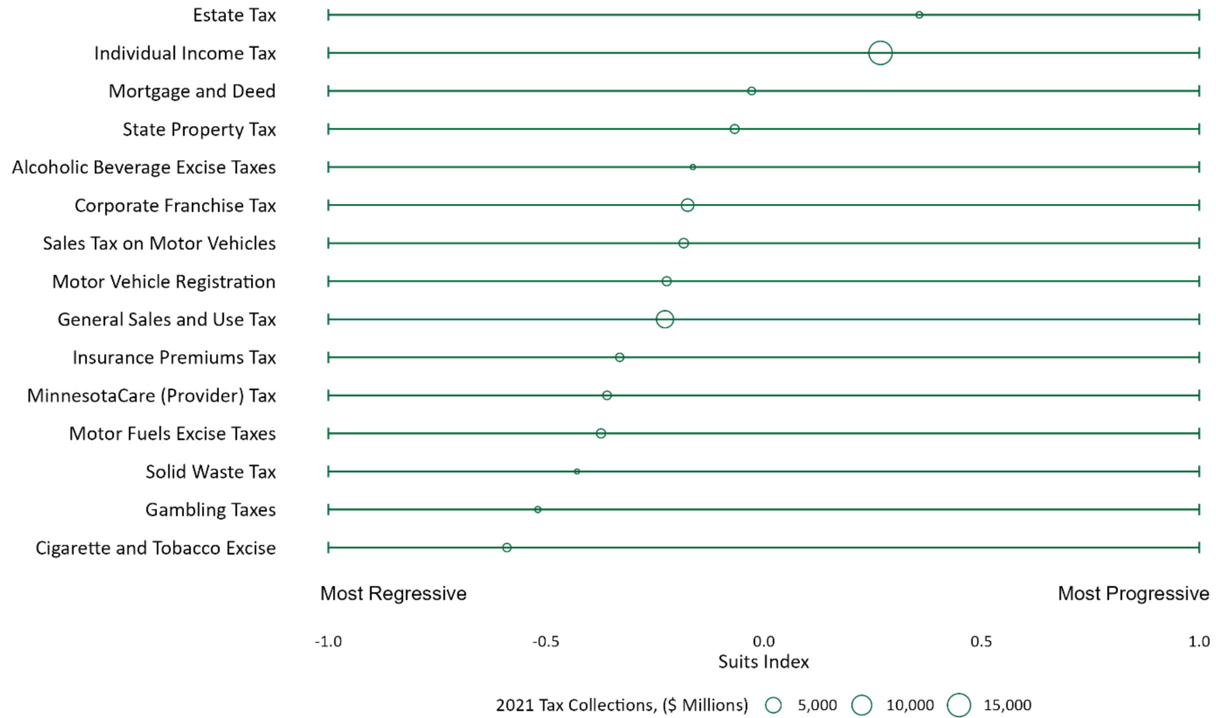
A **regressive tax** is a tax where the effective tax rate is higher for lower-income groups, and lower for higher-income groups.

A **progressive tax** is a tax where the effective tax rate is higher for higher-income groups, and lower for lower-income groups.

One way to measure the incidence of a tax is the Suits Index. That index classifies taxes on a scale from –1 to 1. A perfectly regressive tax, where the lowest income individual bears the entire burden of the tax, has a Suits index of –1. A perfectly progressive tax, where the highest-income individual pays the full amount of the tax, has a Suits Index of 1. A perfectly proportional tax, where every individual pays the same amount of tax as a share of income, has a Suits Index of 0. Every two years, the Department of Revenue releases its tax incidence study, which analyzes the incidence of the state tax system as a whole, as well as the incidence of the state tax.[1] According to the tax incidence study, most state taxes in Minnesota are regressive, meaning lower-income taxpayers pay a higher share of their total income in tax. The two taxes in the state that are considered progressive are the individual income tax and the estate tax.

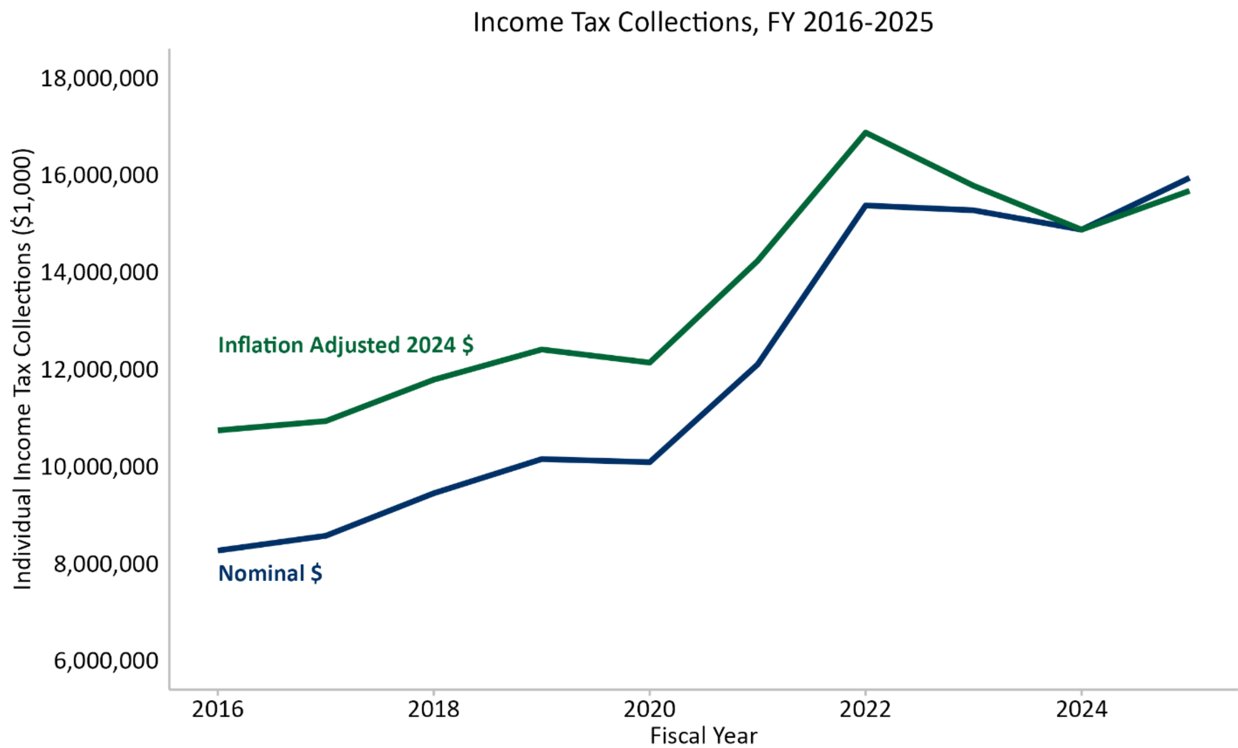
The graph below displays the Suits Index for all state taxes in Minnesota.

[1] Minnesota Department of Revenue. "2024 Minnesota Tax Incidence Study." March 1, 2024. https://www.revenue.state.mn.us/sites/default/files/2024-03/2024-tax-incidence-study-final-online-revision_0.pdf



Progressivity and Regressivity of Minnesota Taxes
Data for Tax Year 2021, from the 2024 Department of Revenue Tax Incidence Study
Estate Tax
Individual Income Tax
Mortgage and Deed
State Property Tax
Alcoholic Beverage Excise Taxes
Corporate Franchise Tax
Sales Tax on Motor Vehicles
Motor Vehicle Registration
General Sales and Use Tax
Insurance Premiums Tax
MinnesotaCare (Provider) Tax
Motor Fuels Excise Taxes
Solid Waste Tax
Gambling Taxes
Cigarette and Tobacco Excise
Most Regressive
Most Progressive
-1.0
-0.5
0.0
0.5
1.0
Suits Index
2021 Tax Collections, ($ Millions)
5,000
10,000
15,000
Data from the DOR 2024 Tax Incidence Study. Graphic by House Research Department.

The Individual Income Tax



Revenues

The individual income tax is the largest state tax by total revenue generated, and is projected to raise $14.9 billion in revenue in fiscal year 2024 (MMB November 2024 forecast).

Reliance on the federal tax

The Minnesota individual income tax closely follows the federal individual income tax. It applies a progressive tax rate structure to taxable income, a measure of net income that is adjusted for family size (by allowing a dependent exemption) and is reduced by a variety of deductions.

- Taxpayers do much of the calculation of the tax base in filling out the federal form.
- The law incorporates federal law by reference.
- Federal compliance and enforcement efforts generally flow through to the state and vice versa.
- **Policy implications.** The heavy reliance on the federal tax has some important policy implications.
  - Reliance on the federal tax makes it relatively easy for taxpayers to comply with and for the state to administer the tax.

- The state must regularly (usually annually) adopt changes made by congress to keep in close step with the federal tax. A 1971 Minnesota Supreme Court held that Minnesota could not automatically incorporate future federal tax changes in defining Minnesota taxable income. *Wallace v. Commissioner of Taxation*, 184 N.W.2d 588 (Minn. 1971). The court concluded that this would unconstitutionally delegate legislative power to tax to congress. The constitutions in some other states explicitly or by court decision allow automatically link state tax bases to change in federal law.
- Minnesota's policy options are limited on basic issues of the tax base; the state is in a sense captive to congressional decisions.

Minnesota tax rates and alternative minimum tax

Rates

Minnesota's income tax rates for tax year 2023 are 5.35 percent, 6.80 percent, 7.85 percent, and 9.85 percent.

Minnesota Tax Rates and Brackets, 1998-2025

Brackets for married joint filers*	1998	1999	2000-12	2013-18	2019 - present
$0 to $47,620	6%	5.5%	5.35%	5.35%	5.35%
$47,621 to $189,180	8%	7.25%	7.05%	7.05%	6.80%
$189,181 to $330,410	8.5%	8%	7.85%	7.85%	7.85%
Over $330,410	8.5%	8%	7.85%	9.85%	9.85%

* Brackets shown are at 2025 levels; and are adjusted for other filing statuses

Alternative Minimum Tax (AMT)

Minnesota also has an individual AMT that uses a broader tax base and has a lower rate (6.75 percent). If an individual's tax is higher under the AMT than under the regular tax, the individual must pay the AMT. The AMT typically affects taxpayers with large amounts of certain deductions or preference items. The itemized deductions for property taxes and home mortgage interest and accelerated depreciation are the tax preferences that most often subject taxpayers to the Minnesota AMT. The 2006 tax law substantially increased the AMT exemption amounts, and reduced the number of taxpayers subject to the AMT. House Research estimates that about 4,700 taxpayers are projected to pay about $20.0 million in AMT for tax year 2025.

Net Investment Income Tax (NIIT)

The 2023 tax law established a new tax on high-income taxpayers with large amounts of investment income, which was first effective for tax year 2024. The NIIT is a 1 percent additional tax on net investment income in excess of $1 million. Net investment income includes:

- Interest
- Dividends
- Long- and short-term capital gains
- Rental and royalty income
- Nonqualified annuities
- Income from businesses involved in trading of financial instruments or commodities
- Certain passive business income

Minnesota deductions and credits

Difference between deductions and credits

- **Deductions**. A deduction (also called a "subtraction") is a subtraction from taxable income. The value of a deduction equals a taxpayer's marginal tax rate multiplied by the amount of the deduction. As an example, a taxpayer in the 9.85 percent bracket who qualifies for a $1,000 deduction receives a tax benefit of $98.50 from the deduction. Low-income taxpayers may not benefit from a deduction. A taxpayer whose taxable income is reduced to zero by federal deductions and exemptions would not benefit from the same $1,000 deduction.
- **Credits.** A credit is a subtraction from tax liability. A nonrefundable credit can be used to reduce liability to zero. A refundable credit, in contrast, is paid to the filer as a "refund" if the credit amount exceeds liability. As an example, a taxpayer who has $500 of liability and qualifies for a $1,000 nonrefundable credit has his or her liability reduced to zero. In effect, this taxpayer only benefits from the first $500 of the credit. If the credit were refundable, the filer would receive a $500 refund in addition to having liability reduced to zero.

Minnesota additions

Minnesota requires various types of income to be added to federal taxable income. These include:

- Interest from municipal bonds of another state or political subdivision of another state (also federally tax-exempt dividends from mutual funds that invest in other states' municipal bonds)
- Expenses deducted federally that are attributed to income not taxed by Minnesota
- Additions resulting from explicitly not conforming to federal law:
    - Bonus depreciation deduction
    - Net operating loss carryover (NOL) adjustments for years when Minnesota did not conform to more generous federal NOL carryback rules
    - Numerous changes included in recent federal tax law changes to which Minnesota has not yet conformed

Minnesota itemized deductions

Beginning in tax year 2019, Minnesota established its own standard deduction amount and set of itemized deductions. Taxpayers may elect to itemize their deductions or claim the standard deduction. For tax year 2025, the standard deduction amounts are as follows:

- Married taxpayers filing joint returns and surviving spouses: $29,900
- Single taxpayers and married taxpayers filing separately: $14,950
- Head of household taxpayers: $22,500

Under current law, Minnesota allows the following itemized deductions:

- **Taxes paid:** Up to $10,000 of property and certain foreign taxes paid.
- **Charitable contributions:** Allowed under federal law, up to 60 percent of FAGI.
- **Interest:** Mortgage interest and investment interest allowed as a federal deduction.
- **Medical expenses:** In excess of 10 percent of the taxpayer's FAGI.
- **Unreimbursed employee expenses:** In excess of 2 percent of the taxpayer's FAGI.
- **Losses:** Personal casualty and theft losses in excess of 10 percent of the taxpayer's FAGI.
- **Miscellaneous deductions:** Miscellaneous deductions allowed federally.

Income-based limitation on standard and itemized deductions: Minnesota's itemized and standard deduction are subject to an income-based limitation, which occurs in three tiers. In tax year 2025, the deductions are phased out as follows for most taxpayers (the thresholds are half the amounts listed for married taxpayers filing separate returns):

- **Tier 1:** Standard and itemized deductions are reduced by 3 percent of adjusted gross income in excess of $238,950.
- **Tier 2:** Standard and itemized deductions are reduced by 10 percent of adjusted gross income in excess of $330,300.
- **Tier 3:** Standard and itemized deductions are immediately reduced by 80 percent for taxpayers with adjusted gross incomes in excess of $1,083,150.

Minnesota subtractions

In addition to the standard and itemized deductions, Minnesota allows various state subtractions. Taxpayers may claim these subtractions regardless of their decision to itemize their deductions or claim the standard deduction. These include:

- Subtractions required by federal law:
  - Interest on U.S. government obligations
  - Railroad retirement benefits
  - On-reservation earnings of members of an Indian tribe
  - Pay for active service performed in Minnesota by nonresident members of the military

- Subtractions required by not conforming to federal law:
  - Portion of bonus depreciation added to MN taxable income in previous years
  - Net operating loss carryover adjustments
  - All or part of a taxpayer’s Social Security benefits, depending on a taxpayer’s income
  - K-12 education expenses (discussed more under the K-12 credit)
  - Charitable contributions: taxpayers who do not itemize at the federal level may deduct 50 percent of charitable contributions that exceed $500.
  - Military pay
    - for active duty performed by Minnesota residents
    - for National Guard and reserve active service, training, and administrative functions (AGR)
  - Military retirement pay, including survivor benefit payments
  - Elderly subtraction
  - Up to $10,000 of unreimbursed expenses related to organ donation
  - Gain on sale of farm property if taxpayer is insolvent
  - Foreign tax payments that exceed the federal foreign tax credit
  - Post-service education awards for service in AmeriCorps
  - Interest earned in first-time homebuyer savings accounts
  - Reciprocity subtraction (residents of Michigan and North Dakota)
  - Railroad expenses for which the federal railroad track maintenance credit is claimed (Because the federal credit is in lieu of the business expense deduction, taxpayers would otherwise not be allowed to deduct these expenses in computing Minnesota tax—that is, these expenses are not reflected in federal taxable income.)
  - Up to $3,000 in contributions by a married joint taxpayer to a section 529 college savings account ($1,500 for other taxpayers). The subtraction is limited to individuals who do not claim the 529 credit.
  - Discharged student loans that are included in federal adjusted gross income
  - Business expenses of medical cannabis manufacturers
  - Deferred foreign income recognized under section 965 of the federal Internal Revenue Code
  - Global intangible low-taxed intangible income (GILTI)
  - Mileage reimbursements paid to volunteer drivers
  - A portion of pension income from pension plans that are uncoordinated with Social Security (commonly referred to as “basic plans” in Minnesota)
  - Damages from sexual harassment and abuse claims that are not excluded from taxable income under federal law

Nonrefundable Minnesota credits

Marriage penalty credit. Designed to offset the penalty implicit in Minnesota's rate and bracket structure. As an example, in tax year 2025 single filers pay 5.35 percent on the first $32,570 of taxable income, while married joint filers pay 5.35 percent on the first $47,620 of taxable income. Without the marriage penalty credit, two people each with taxable income of $30,000 would pay lower tax as single filers than if they married. As in this example, the rate and bracket structure imposes the largest penalty on married couples with relatively equal incomes; these couples qualify for the largest credit. Taxpayers determine their credit using a look-up table in the tax instructions. The credit amount depends on the couple's taxable income, and the earned income of the lesser-earning spouse. Earned income is defined to include taxable pension and social security income, since those types of income are tied to an individual's earnings history.

The maximum credit depends on the income tax rates in effect in a given year; for tax year 2023 the maximum credit is $1,710. DOR estimates that approximately 422,000 returns claimed the credit in tax year 2023, and that the cost of the credit was about $98,100,000 that year.[2]

Credit for taxes paid to other state. Resident taxpayers pay tax on all of their income, even if it is taxable in another state. If they pay tax on some of their income in another states (e.g., they earned income in another state or had investment income sourced to another state), they are allowed a credit against their Minnesota tax for taxes paid to the other state. The credit is intended to prevent this income from being subject to double taxation. A recent U.S. Supreme Court decision held that state taxes (if they tax all of the income of their residents, not just in-state income) must allow a credit like this (or a similar mechanism) to prevent income for out-of-state sources being taxed more heavily than that from in-state sources. *Comptroller v. Wynne*, 135 S. Ct. 1787 (2015).

Long-term care credit. Taxpayers may claim 25 percent of long-term care insurance premiums paid as a credit, up to a maximum of $100 per beneficiary ($200 for married couples filing joint returns). The credit is only allowed for premiums that are not claimed as an itemized deduction for medical expenses at the federal level. Before tax year 2000, policies had to include inflation protection in order to qualify for the credit. For tax year 2000 and following years, a taxpayer only has to have been offered inflation protection when purchasing the policy in order for the policy to qualify.

In tax year 2023, about 66,000 returns claimed about $9,500,000 in credits.

Credit for past military service. Retired members of the military with at least 20 years of service or who separated due to a disability are allowed a $750 credit. The credit is phased out

[2] Projections of the cost of this and other credits are taken from the Minnesota Department of Revenue's *2024-2027 Tax Expenditure Budget*, available online at *https://www.revenue.state.mn.us/sites/default/files/2025-01/2024-tax-expenditure-budget-162024-revision.pdf*

for taxpayers with adjusted gross income (including military retirement income) in excess of $30,000. In tax year 2022, about 1,300 returns claimed about $200,000 in credits.

Credit for sales of agricultural assets to a beginning farmer. The 2017 legislature enacted a nonrefundable credit for taxpayers who sell or rent agricultural assets to a beginning farmer. The credit is calculated based on the value of the asset or the amount of rental income. The credit is capped at $4,000,000 per year and expires after tax year 2030. The Department of Revenue estimates that the credit will reduce revenues by $4 million in FY 2025. Approximately 500 returns claimed the credit in tax year 2020.

Beginning farmer management credit. The 2017 legislature enacted a nonrefundable credit of up to $1,500 for beginning farmers who participate in a financial management program. A taxpayer may claim the credit for up to three years while participating in the program. The credit sunsets after tax year 2030. The Department of Revenue estimates that the credit will reduce revenues by $500,000 in FY 2025. Approximately 260 returns claimed the credit in tax year 2022.

Student loan credit. The Minnesota Student Loan Tax Credit is a nonrefundable credit for payments of principal and interest on eligible higher education loans. Individuals with one or more qualified education loans may claim the credit to reduce their Minnesota income tax liability by up to $500. The credit was enacted by the 2017 legislature, effective beginning in tax year 2017.

The Department of Revenue estimates that the credit reduced revenues by $12.7 million in tax year 2023, and about 27,700 returns claimed the credit.

College Savings (529) credit. Minnesota's Section 529 Plan Credit is a nonrefundable credit for contributions to a college savings account established by any state under section 529 of the Internal Revenue Code. The credit equals 50 percent of contributions, up to a maximum of $500. The maximum credit is phased out as income increases with varying thresholds for individuals and married joint filers. The credit is fully phased out for individuals with AGI in excess of $100,000 and married couples filing joint returns with income in excess of $160,000.

The Department of Revenue estimates that the credit reduced revenues by $6.9 million in tax year 2023. About 24,400 returns claimed the credit that year.

Credit for a teacher completing a master's degree. The 2017 legislature enacted a credit for teachers who complete a master's degree in a "core content area" other than teaching or pedagogy. The credit is allowed for teachers who begin a degree program in fall 2018 or later, and is earned upon completion of the program. The maximum credit is $2,500, and is allowed once. The Department of Revenue estimates that fewer than $50,000 in credits were claimed in tax year 2023, and projects fewer than $50,000 will be claimed per tax year in the future.

Refundable Minnesota credits

Child and working family credits

Prior to 2023, Minnesota offered a state tax credit called the working family credit which, similar to the federal earned income credit, provided a wage supplement equal to a percentage of low-income taxpayers' earnings. The 2023 tax bill significantly restructured the working family credit, and combined it with a new state child credit.

Under current law, Minnesota offers two refundable income tax credits targeted toward lower-income individuals: the child credit and the working family credit. The two credits are intertwined—taxpayers add together the two credits, and the combined amount is phased down based on income.

Based on returns filed through November 2024, the combined cost of the child and working family credits was about $712.7 million in tax year 2023. About 516,600 returns claimed one or both credits.

Child credit

In TY 2024, taxpayers are eligible for a child credit of $1,750 per qualifying child ages 0 to 17. There is no limit on the number of qualifying children for which a taxpayer may claim a credit in a tax year. There is a smaller credit for "qualifying older children" ages 18 to 23. In tax year 2024, the credit is $970 if a taxpayer has one older child, $2,210 for two older children, and $2,630 for three or more older children. The credit amounts are indexed for inflation: the $1,750 per young child amount increases beginning in TY 2026, and the amounts for older children began to increase in TY 2024.

Working family credit

Lower-income taxpayers are annually eligible for a working family credit equal to 4 percent of the first $9,220 of their earned income resulting in a maximum credit of $369. These amounts were indexed for inflation starting in TY 2024. Earned income is defined federally as wages plus self-employment income.

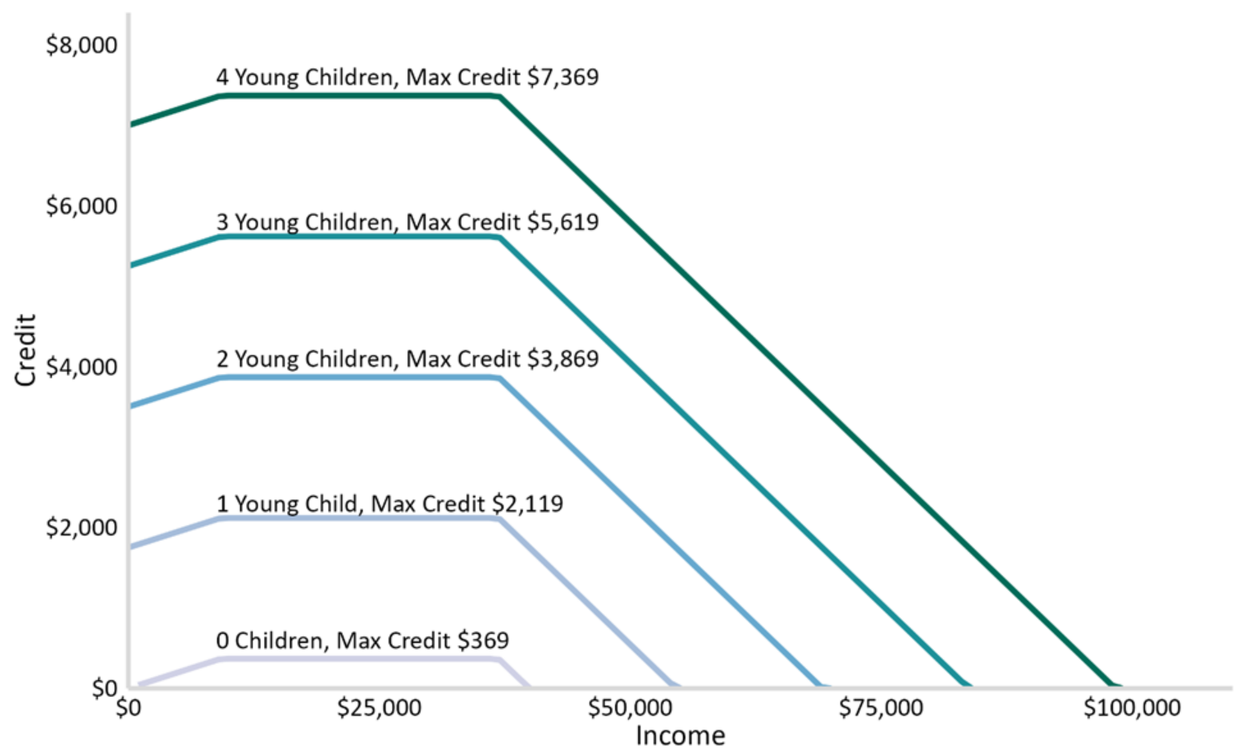
Credit phaseout

The combined amount of the taxpayer's child credit and working family credit is phased out based on the taxpayer's income. In TY 2024, for married joint filers the phaseout begins at $36,880 of adjusted gross income or earned income ($31,090 for unmarried filers). The taxpayer's credit amounts are reduced by 12 percent of income above the starting point for the phaseout, except that for taxpayers with a qualifying older child and no younger children, the phaseout rate is 9 percent.

Maximum Credit Amounts and Incomes at Which Credit is Fully Phased Out, TY 2024

Taxpayer's Number of Children	Maximum Credit	Income Level where Credit is Fully Phased Out	
		Married Joint	Unmarried
No Children	$369	$39,953	$34,163
1 Young Child	$2,119	$54,537	$48,747
1 Young Child and 1 Older Child	$3,089	$62,620	$56,830
2 Young Children	$3,869	$69,120	$63,330
2 Young Children and 1 Older Child	$4,839	$77,203	$71,413
3 Young Children	$5,619	$83,703	$77,913

Maximum Credit Amounts and Incomes at Which Credit is Fully Phased Out, TY 2024



K-12 education credit. A credit is allowed for qualifying K-12 education expenses. The credit equals 75 percent of qualifying education expenses. A maximum credit of $1,500 per child for each child in grades K-12. The credit is subject to an income-based phaseout that starts at $70,000 of income. For families claiming the credit for one or two children, no credit is allowed for incomes over $77,500. The income limit increases by $2,000 for each additional child claimed. The income phaseout is indexed for inflation, but the maximum credit amount is not.

Qualifying K-12 education expenses include academic tutoring, academic books and materials, fees paid for transportation, music lessons and rental or purchase of instruments, after-school enrichment programs and academic summer camps, and up to $200 of computer hardware and educational software.

K-12 education expense deduction

In addition to the credit, a deduction for K-12 education expenses is allowed. The maximum deduction is $1,625 for each child in grades K-6, and $2,500 for each child in grades 7-12. The benefit depends upon the tax rate; a taxpayer in the top bracket (9.85 percent) would derive a $246 benefit from a $2,500 deduction. Taxpayers may not claim both the deduction and the credit for the same expenses. The same expenses qualify for the deduction as for the credit, with the exception that nonpublic school tuition qualifies for the subtraction but not the credit.

As of January 2025, DOR estimates that about 45,100 Minnesota returns claimed a total of $15.4 million in K-12 education credits in tax year 2023. The average credit was $342.

Dependent care credit. The Minnesota and federal dependent care credits partially offset the cost of child care for certain workers. The maximum Minnesota and federal credit is $1,050 for one child and $2,100 for two or more children. The dependent care credit uses the definition of qualifying expenses under the federal dependent care credit. The Minnesota credit differs significantly from the federal credit, however. The federal credit is not refundable and is claimed mainly by middle and upper income taxpayers. The Minnesota credit, by contrast, is refundable and limited to lower income families.

The *state credit* equals the federal credit for which the claimant is eligible, subject to an income-based phaseout. While all filers with tax liability and qualifying expenses may claim the federal credit, the state credit is fully phased out for filers with higher incomes. In tax year 2025, the phaseout begins when adjusted gross income exceeds $64,150 and the credit is fully phased out when income reaches $76,150 for claimants with one dependent, and $88,150 for claimants with two or more dependents. The income threshold for the phaseout is adjusted each year for inflation.

DOR estimates that about 43,500 returns claimed approximately $26.3 million in credits in tax year 2023.

Combat zone military service credit. Allows a refundable credit of $120 for each month served in a combat zone or qualified hazardous duty zone during the tax year. According to the Department of Revenue, about 660 returns claimed the credit in 2022. DOR estimates that $1,000,000 in credits will be paid in fiscal year 2024.

Stillbirth credit. The 2016 legislature enacted a refundable credit of $2,000 for the parents of a stillborn child. DOR estimates the credit will reduce revenues by $400,000 in FY 2025. Approximately 200 returns claimed the credit in tax year 2022.

Refundable credit for taxes paid to Wisconsin. Minnesota's credit for taxes paid to another state is not refundable. The 2017 legislature enacted a refundable credit for taxes paid to Wisconsin. The credit applies to personal service income (such as wages) only. The credit only applies if no tax reciprocity agreement is in place with Wisconsin; the credit effectively mimics the tax treatment under reciprocity. DOR estimates the credit reduced revenues by $1 million in tax year 2023.

Small business investment credit (AKA the "angel credit"). Enacted in 2010, the angel credit allows a credit for investments in Minnesota small businesses up to $250,000 for married joint filers or $125,000 for other filers. The credit is capped for a certain amount each year. This credit has been extended on a temporary basis over the years by the legislature and is expired for tax years beginning in 2025.

Renter's credit. Beginning in tax year 2024, the renter's credit will be administered as a refundable income tax credit. The credit was previously administered as a stand-alone property tax refund program, but the 2023 tax bill modified the credit to make it part of the income tax system.

Nonrefundable and refundable Minnesota business credits. Minnesota allows a number of tax credits for businesses. Because a business may be organized as a pass-through business (or sole proprietorship) or C corporation, these credits are available to taxpayers under both the individual income tax and the corporate franchise tax. The following business credits are available under the individual income tax and are described in more detail in the corporate franchise tax section of this document beginning on page 39:

- Transit pass credit
- Research credit
- Short line railroad credit
- Housing credit
- Film credit
- Sustainable aviation fuels credit
- Manufactured home park credit
- Historic structure credit

Modeling capabilities

Both House Research and the Fiscal Analysis Department use the House Research Income Tax Simulation (HITS) model to prepare estimates of the effect of changes to the income tax system. The model uses a sample of income tax returns and the growth assumptions made in the most recent economic forecast prepared by Minnesota Management and Budget. Minnesota Management and Budget, the Department of Revenue and the Minnesota Senate

use the same model to estimate the impact of income tax changes and in preparation of state revenue forecasts. Types of changes that can be modeled include changes to the rates, exemption amounts, deductions, and changes to the various credits.

Historical highlights

1933: Enactment

Tax was first enacted in 1933 with rates ranging from 1 percent to 5 percent. Minnesota was one of the first states to enact an individual income tax, although a few states enacted income taxes (and repealed them) in the 19th century. Some features of the original Minnesota tax:

- One rate schedule was used, i.e., no separate filing statuses for married couples, singles, and so forth. Each individual paid tax on his or her own income.
- Federal income taxes were deductible.
- A large number of itemized deductions were allowed.
- Personal credits were provided, rather than the exemption amounts.

1961: Withholding tax

Withholding tax was imposed in 1961. Before enactment of the withholding tax, all filers were required to directly pay the tax.

1961: Tying tax to the federal tax

In 1961, the tax was first directly linked to the federal income tax by adopting federal adjusted gross income as the starting point in computing the tax base.

1970s: Rate changes

Various surtaxes and rate increases were imposed over the years. The “Minnesota Miracle” in 1971 was financed with a significant increase in the rates. At one point during the 1970s the top rate was increased to 18 percent, although this rate was repealed before it went into effect. A top rate of 17 percent applied for a period of time in the 1970s; federal taxes were deductible, though.

1979: Indexing

The 1979 legislature indexed the tax bracket, standard deduction, and personal credit amounts for inflation.

Early 1980s: Temporary rate increases

Temporary surtaxes were imposed during the recessions in the early 1980s, to help make up for downturns in state revenues. These surtaxes were repealed when the economy recovered from the recession.

1985: Closer conformity to federal tax

The 1985 legislature made major changes, including:

- Substantial rate reduction
- Federal filing status rules (Before 1985, the Minnesota tax applied on an individual bases; with the adoption of federal filing status rules, the possibilities of marriage penalties and bonuses were created)
- Optional rate schedule with lower rates and no federal tax deduction

1987: Tax reform

In the wake of the 1986 federal tax reform, the 1987 legislature dramatically restructured the tax. The changes included:

- Adopted FTI as the starting point for the Minnesota calculations. This had some important effects:
  - Eliminated personal and dependent credits in favor of personal and dependent exemptions
  - Eliminated the federal income tax deduction (at this point, the deduction was an option that subjected the taxpayer to a higher rate schedule)
  - Adopted all the federal rules for itemized deductions
  - Eliminated a number of state deductions, such as the pension exclusion, the deduction for military pay, and unemployment compensation exclusion
  - Adopted federal tax reform changes, including the new passive loss rules, and the repeal of the 60 percent exclusion for capital gains and the sales tax deduction
  - Major simplification – the tax was now reported on one page form with considerable "white space"
- Reduced tax rates – top rate was now 8 percent (with "bubble" applying marginal rate of 8.5 percent to some taxpayers)

1991: Working family credit and rate increase

In 1991, the legislature increased the top rate to 8.5 percent ("bursting the bubble") and adopted the working family credit (Minnesota's earned income credit). This credit began at 10 percent of the federal earned income credit. It has been increased in later legislative sessions so that the average working family credit claimed in Minnesota for 2010 was about 31 percent of the average federal earned income credit claimed in Minnesota.

1997-1998: Property tax rebates

In 1997 and 1998, the individual income tax system was used to provide large (about $500 million each) property tax rebates.

1997: K-12 credit

In 1997, the refundable credit for K-12 education expenses was provided, effective in 1998. In 2001 (effective for tax year 2002), the credit was limited to 75 percent of qualifying expenses.

1999-2000: Rate reduction

In 1999 and 2000, the legislature enacted substantial across-the-board cuts in the tax rates. The bottom rate was reduced from 6 percent to 5.35 percent and the top rate from 8.5 percent to 7.85 percent.

1999: Marriage penalty credit

The 1999 legislature enacted the marriage credit to address the "marriage penalty" that results from the difference in widths between the married and single rate brackets (as described above under 0)

2000: Transit pass credit

The 2000 legislature enacted this credit to encourage employers to subsidize transit passes for their employees.

2006: Bovine tuberculosis testing credit and military service credit

The 2006 legislature enacted the Bovine Tuberculosis credit in response to the appearance of Bovine TB in the state; feeder cattle must be tested before being shipped out of state until the federal government declares the state free of the disease. The military credit equals $59 for each month of service in a combat zone of qualified hazardous duty area, retroactive to September 11, 2001.

2008: Credit for past military service, motor fuels credit, and expansion of military pay subtractions (all effective in tax year 2009)

The 2008 legislature enacted a new credit for military retirees, phased out for those with income over $30,000. It included in the Transportation Finance Law a credit intended to at least partially offset the motor fuels tax increase on taxpayers in the first income tax bracket. It also provided new subtractions for military pay for training in Minnesota, and for active service performed by Minnesota residents in Minnesota.

2009: Section 125 health insurance credit

The 2009 legislature enacted the section 125 health insurance credit for moderate income individuals who enrolled in these plans and did not previously have health insurance. This credit was repealed by 2011 legislature.

2010: Angel investment credit, research credit, historic rehabilitation credit

The 2010 legislature enacted two refundable new credits, the angel investment credit and the historic rehabilitation credit, and extended the existing corporate franchise tax credit for

research and development to S corporations and partnerships under the individual income tax credit. In addition, the research credit was made refundable. To finance the cost of these new credits, the motor fuels credit was repealed.

2011: Mixed messages on federal conformity

The 2011 legislature chose not to conform to the federal extension of the increased standard deduction for married joint filers, or to the extension at the federal level of the elimination of both the phaseout of personal and dependent exemptions and the limitation on itemized deductions. But the legislature did come back into conformity on the higher education tuition deduction and the educator classroom expense deduction, and, for tax year 2011 only, modified the working family credit parameters to match the federal extension of the earned income credit phaseout for married filers.

2013: Fourth (higher top rate) bracket adopted; no conformity

The 2013 legislature adopted a fourth tier bracket with a rate of 9.85 percent that applied to married joint filers with taxable incomes above $250,000 and chose not to conform to changes in federal taxable income that Congress enacted in 2012.

2014: Retroactive conformity

The 2014 legislature reversed the decision of the 2013 legislature to not conform on numerous of the federal provisions, retroactive to tax year 2014, and prospectively for other provisions (e.g., the higher standard deduction for married joint filers).

2015: One year of conformity

The 2015 legislature adopted conformity for federal changes through 2014, the only tax bill that was enacted into law during the 2015 session.

2016: Subtraction for military retirement pay

The 2016 legislature did not enact a tax bill (as a result of the governor's pocket veto of the omnibus tax bill), but did enact in a supplemental spending bill the subtraction for military retirement pay, the stillbirth credit, and a one-year extension of the angel investment credit with a $10 million annual limit for tax year 2017.

2017: Conformity and new tax expenditures

The 2017 legislature enacted an early conformity bill on January 12, as well as an omnibus tax bill during the May special session. The omnibus tax bill significantly expanded a number of individual income tax expenditures. The bill included four new subtractions, including a partial subtraction for taxable Social Security Benefits. It also included five new nonrefundable credits for college savings account contributions, student loans, beginning farmers, and teachers who complete master's degrees. The bill enacted a new refundable credit for taxes paid to Wisconsin, and expanded the refundable working family credit, dependent care credit, and the research and development credit.

2018: Nonconformity to significant federal tax changes

Congress enacted the Tax Cuts and Jobs Act (TCJA) in December 2017. TCJA made a number of significant changes that affected the calculation of federal taxable income (FTI), which is the starting point for Minnesota's individual income tax. The bill limited and repealed certain itemized deductions, repealed the personal and dependent exemptions, increased the standard deduction, and made numerous changes to the tax treatment of pass-through businesses. The 2018 legislature passed two bills conforming to these changes and significantly restructuring the state tax system, but the bills were vetoed by the Governor. As a result, the state was out of conformity with the TCJA's changes for tax year 2018.

2019: Shift to FAGI as a starting point, conformity second-tier rate cut, expansion of tax expenditures

The 2019 legislature significantly restructured the state's income tax. The 2019 omnibus tax bill conformed to many of the changes in TCJA (excluding provisions affecting foreign income), and moved the starting point for the state's income tax to federal Adjusted Gross Income (FAGI). The state enacted a state dependent exemption (equal to the amounts allowed federally prior to TCJA) as a family size adjustment, and established state standard and itemized deductions. The itemized deductions the legislature enacted largely mirrored what was allowed federally after TCJA, except the legislature opted to retain deductions for casualty losses and unreimbursed employee expenses. The state retained its income-based limitation on itemized deductions and applied the same limit to the state standard deduction.

The 2019 omnibus tax bill additionally reduced the second tier rate from 7.05 percent to 6.80 percent, expanded the Working Family Credit and Social Security subtraction, and changed the measure of inflation used to adjust the state's income tax.

2020: Section 179 conformity

The omnibus tax and bonding bill enacted in the 5th special session of 2020 fully conformed Minnesota to the federal rules for section 179 expensing, effective for tax years 2020 and later.

2021 session: Partial conformity to federal COVID response measures; enactment of new tax expenditures; pass-through entity tax established

The 2021 legislature opted to partially conform to changes in the federal Internal Revenue Code, rather than adopting the Code as amended through a particular date. The conformity provisions adopted included business extender provisions for tax year 2020 only, and conformity to certain aspects of the federal government's response to the COVID pandemic. The pandemic-era measures adopted included nontaxability of Paycheck Protection Loans and EIDL loans, and an exclusion from gross income for a portion of unemployment insurance benefits.

The tax bill additionally established new tax expenditures, including a temporary credit intended to encourage affordable housing development, a temporary film credit, and a

subtraction for reimbursements paid to volunteer drivers. The bill additionally extended the historic structure rehabilitation credit and the small business investment (angel) credit.

The omnibus bill also authorized pass-through entity tax as a workaround for the federal limitation on the state and local tax (SALT) deduction. The tax allowed partners, shareholders, and owners of pass-through entities to pay the individual income tax at the entity level, meaning the taxes paid are not subject to the SALT limitation federally.

2023 session: increased taxes on high-income individuals; conformity to federal COVID response; enactment of new tax expenditures; expansion of tax expenditures; business tax base expansions

Taxes on high earners: The 2023 tax bill imposed new taxes on high-income Minnesotans, including establishing the net investment income tax (NIIT) discussed earlier. The bill also made the standard and itemized deduction phaseout more aggressive, which increased taxes on taxpayers with adjusted gross incomes of at least $304,970.

Expansion of tax expenditures: The bill also consolidated the working family credit with a new child credit, increased the income eligibility and maximum credit amount for the Minnesota education credit, expanded the subtraction for Social Security benefits, and expanded the renter's credit while converting it to be part of the income tax system, rather than a stand-alone property tax refund. The bill reauthorized expiring tax expenditures for film production, angel investments, beginning farmers, and historic structures. Finally, the bill created new tax expenditures in a variety of areas, including for certain public pension benefits, sales of manufactured parks to cooperatives, short line railroad modernization, and sustainable aviation fuels.

Conformity: In 2023, the legislature enacted a substantial conformity bill that addressed all outstanding COVID related tax conformity issues. Conformity to federal provisions for business interest and net operating losses having retroactive and multi-year effects federally were allowed on a prospective basis in Minnesota.

Business tax base expansions: The bill expanded the corporate tax base by repealing the state subtraction for global intangible low-taxed income (GILTI) and reducing the dividend received deduction. The pass-through entity tax was also expanded to allow tiered partnerships to qualify, and to allow 100 percent of a resident partner's income to qualify for the credit.

Recent trends in policy changes to tax

Surveying the last 25 years or so of changes to the Minnesota individual income tax system, three trends stand out.

Major reform and simplification early in the period

During the 1985-87 sessions, the governor and legislature undertook major efforts to simplify and "reform" the tax. The pre-1985 tax was quite complex. It was out of step with federal tax in some respects (e.g., in using individual, rather than married couple, filing and using personal

credits rather than exemptions). Furthermore, it reflected an accumulation of many policy decisions to use the tax system to further non-tax goals (e.g., encouraging solar energy, pollution clean-up, and conservation tillage, to name a few) and to make micro adjustments to achieve equity goals (e.g., personal credits, rather than exemptions). The 1985 and 1987 changes are quite remarkable in clearing the underbrush and ending up with a very simple tax that closely followed the federal tax with only a few unimportant differences.

Growing use of the tax to administer transfers and payments to businesses

A second trend, beginning during the 1990s and continuing since, was the cooption of the tax as a mechanism for delivering income transfers and program payments. Policymakers have discovered that the tax provides a relatively efficient way to make modest payments to large numbers of recipients using refundable credits. These credits are paid to recipients as refunds, when they exceed the recipient's tax liabilities. Minnesota has long provided a refundable dependent care credit (since 1977), but this was a modest enterprise (few affected taxpayers and small cost). The 1990s saw the addition of two much larger transfer programs with the working family credit and the education credit. In 2006 Minnesota added two new refundable credits, for bovine tuberculosis testing costs and a credit analogous to a bonus for military service in combat zones since September 11, 2001. In 2008 Minnesota added two more credits (past military service and motor fuels for lower-income taxpayers, both effective in tax year 2009 with the first cost appearing in FY 2010). In 2009 another credit (the section 125 health insurance credit) was added, although this credit was nonrefundable. 2010 saw a net increase of two refundable credits with the enactment of three new credits (angel investment, historic rehabilitation, and research) and repeal of one refundable credit (motor fuels). In 2011, the section 125 health insurance credit was repealed. The 2013 legislature eliminated the refundability for the research credit.

In 2013, the legislature enacted the greater Minnesota internship credit and in 2014, the legislature enacted a 75 percent refundable credit (maximum of $2,000) for expenses incurred by parents or guardians to treat reading disorders. This credit was limited to tax year 2014 and was estimated to reduce revenues by $2.6 million. It has now expired.

In 2016, the legislature enacted the credit for parents of stillborn children.

The 2017 legislature repealed the greater Minnesota internship credit, but enacted six new tax credits and expanded the working family, dependent care, and research credit. The new credits were the student loan credit, two credits for beginning farmers, a credit for college savings account contributions, a credit for teachers who complete master's degrees, and a credit for taxes paid to Wisconsin.

Below are the numbers claiming refundable credits in tax year 2023 (except as otherwise noted) and their projected costs in FY 2025. The costs include both the offset against tax and refund amounts.

Refundable Credit	Approximate Claimants	FY 2025 Cost
Dependent Care	43,500 (2023)	$27,100,000
K-12 Education	126,500 (2023)	15,400,000
Working family	522,136 (2023)	724,800,000
Military service (combat zone)	660 (2022)	800,000
Stillbirth credit	200 (2022)	400,000
Taxes paid to Wisconsin	5,700 (2022)	1,100,000
Estimates of claimants and FY 2023 cost are from the Department of Revenue, *Tax Expenditure Budget FY 2024-2027*, except child and K-12 credit estimates are based on preliminary return data shared by the Department of Revenue. Estimate of the claimants for the credit for taxes paid to Wisconsin was estimated by House Research using the House Income Tax Simulation (HITS) model, version 7.5.		

Creeping complexity

The 1987 Act was the high-water mark for simplification. Since then, the legislature has slowly been adding features to the tax for many of the same policy reasons that underlay the provisions that were repealed in 1985 and 1987. Some of these include:

- Elderly exclusion
- K-12 education credit
- Charitable contribution subtraction for nonitemizers
- Credit for long-term care insurance
- Transit pass credit
- Marriage penalty credit
- Student loan credit
- Two credits for beginning farmers
- A credit for teachers who complete master’s degrees.
- Stillbirth credit
- Credit for taxes paid to Wisconsin
- Child credit
- Subtraction for disposition of farm property
- Subtraction for foreign taxes in excess of the federal foreign tax credit
- Subtraction for organ donation expenses
- Subtractions for various categories of military pay
- Subtraction for railroad track maintenance expenses not allowed as federal deductions (but used to claim a federal credit)
- Subtraction for discharged student loans

- Subtraction for a portion of taxable Social Security benefits
- Subtraction and credit for 529 contributions
- Subtractions for interest earned in first-time homebuyer accounts
- Failure to conform to special federal rules relating to bonus depreciation and recognition of net operating losses
- Subtraction for the business expenses of medical cannabis manufacturers
- Subtraction for reimbursements paid to volunteer drivers
- Subtractions for a portion of pension income from uncoordinated pension plans (also known as “basic plans”)
- Subtraction for some sexual harassment settlements

Sales Taxes

Minnesota is one of 46 states (including DC) that levies a sales and use tax.

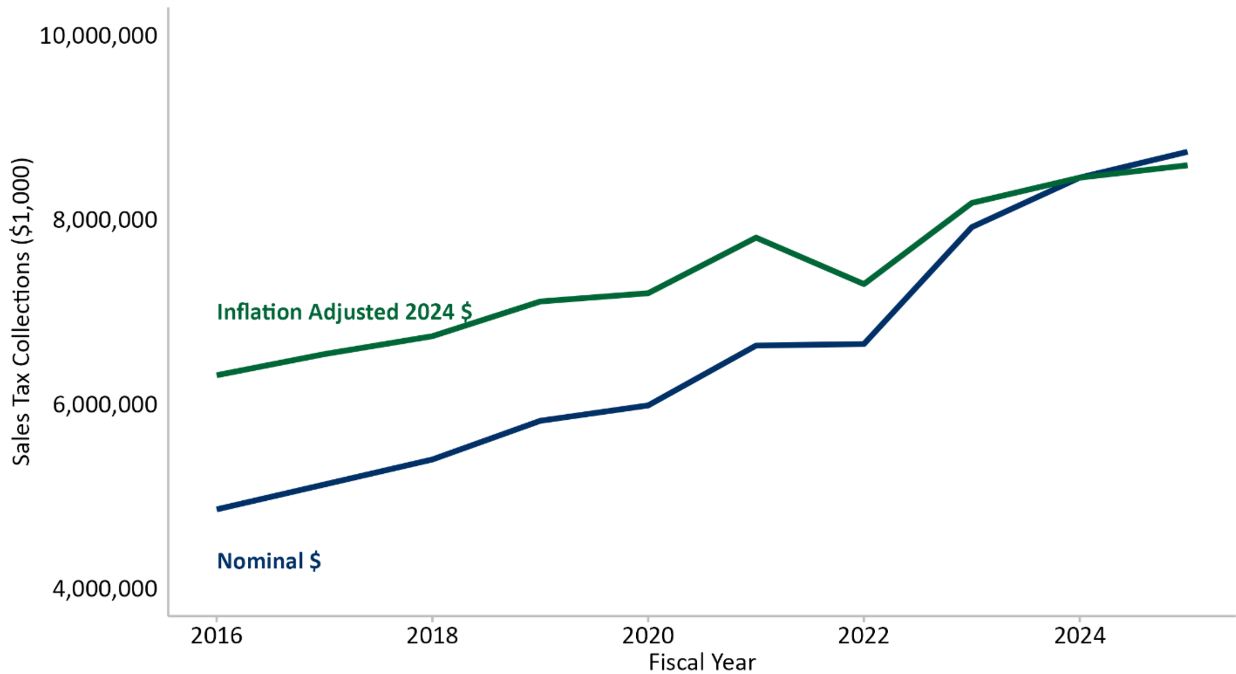
Tax rate and tax base

The state general sales tax rate is 6.5 percent. However, a 2008 voter-approved, state constitutional amendment imposed an additional three-eighth cent general sales tax (0.375 percent), bringing the total sales tax rate to 6.875 percent. The tax is imposed on all final sales and uses of tangible personal property and a limited number of services occurring within the state. The revenue collected from this tax is deposited into the state general fund.

Like most states with a sales tax, Minnesota has a complementary "use tax." If the seller does not collect the tax on a taxable item used in the state, the purchaser is responsible for submitting the tax owed. Most businesses pay use tax but few individuals do. In 1996, the state enacted a *de minimis* exemption for individuals. An individual does not owe a use tax unless his/her purchases subject to the use tax exceed $770 per year ($53 of tax liability).

Amount of state revenue generated

The general sales tax, motor vehicle sales tax, and payments in-lieu of sales tax on lottery tickets will raise a combined $9.5 billion in fiscal year 2024. $7.5 billion is from the general sales tax, $442.8 million from the rate under the Legacy Amendment (0.375 percent rate), $1.129 billion from motor vehicles sales tax and $50.4 million from lottery tickets. Sales taxes account for slightly less than 30 percent of total state tax revenues.



Distribution of the sales tax burden

The *Minnesota Tax Incidence Study* estimates how the sales tax burden is distributed across Minnesota households. Because the sales tax burden as a percent of income falls steadily from 7.5 percent of total income for the poorest fifth of Minnesota households to 1.8 percent of income for the richest fifth of Minnesota households, economists describe the sales tax as a *regressive* tax. For more information regarding the distribution of sales tax burden, reference the *Minnesota Tax Incidence Study* published by the Department of Revenue.

Dedication of revenue

Motor vehicle-related sales tax revenues dedicated to transportation funding

The state dedicates some of the general sales tax revenue related to motor vehicles to transportation funding. This started with the dedication of most of the sales tax revenues from long-term motor vehicle leases in 2008. In 2017 all sales taxes from long-term motor vehicle leases were dedicated to transportation along with revenues generated by both the general and special sales taxes from short-term motor vehicle leases[3]; and also the sales tax revenues estimated to be derived from the sale of motor vehicle repair parts.

- **Revenues from long-term motor vehicle leases.** Currently 100 percent of these revenues are statutorily dedicated to transportation purposes with the money distributed as follows:
  - 38 percent to the county state-aid highway fund;
  - 38 percent to the greater Minnesota transit account;
  - 13 percent to the Minnesota transportation fund; and
  - 11 percent to the highway user tax distribution fund.

  The portion going to the county state-aid highway fund is distributed to the counties in the seven county metropolitan area <u>except</u> for Hennepin and Ramsey Counties, based on county population.

- **Revenue from short-term motor vehicle leases.** Beginning July 1, 2017, the revenue from both the regular and extra sales taxes imposed on short-term motor leases is dedicated to the highway user tax distribution fund. The special taxes on these leases are reported separately and the general sales tax revenues from these leased are estimated based on the special tax revenue.

- **Revenue from motor vehicle repair parts.** Repair parts for motor vehicles are sold by car dealers, auto repair stores and general merchandise retail stores. Remittance of sales taxes collected on these items are not reported by retailers separately therefore the statute includes a set amount of general sales tax revenue to be moved to the highway use tax distribution fund. The amounts dedicated are:
  - $2.628 million/month from July 1, 2017, through June 30, 2019; and
  - $12.137 million/month beginning July 1, 2019.

---

[3] Short-term motor vehicle leases are leases of passenger automobiles, vans, and pickup trucks for 28 or fewer days. An additional 9.2 percent special sales tax is imposed on these leases in addition to the 6.875 percent general sales tax,

In-lieu tax on lottery tickets dedicated to legacy funds

72.43 percent of the revenue collected from the in-lieu tax on lottery tickets is deposited in various natural resources funds to fund natural resource conservation and enhancement, trails, and zoos. The remainder goes to the general fund.

The legacy amendment sales tax increase

In 2008, voters approved a constitutional amendment to increase the general state sales tax by 3/8th of 1 percent (0.375 percent). The additional rate was imposed for twenty years, beginning July 1, 2009. The revenue raised by the additional tax is estimated to be $442.8 million in FY 2024. The revenue is dedicated as follows:

- Outdoor heritage fund – 33.00 percent
- Clean water fund – 33.00 percent
- Parks & trails – 14.25 percent
- Arts & cultural heritage – 19.75 percent

The rate increase affects all sales subject to the general sales tax under Minnesota Statutes, chapter 297A. However, the rate increase does not apply to the motor vehicle sales tax (MVST), which is imposed under chapter 297B.

Tax base considerations

In theory the sales tax is a broad-based tax levied on final consumption and not on intermediate goods, but in reality this is not true. In Minnesota the sales tax is a transaction tax rather than a consumption tax. Many final consumer purchases of goods and services are exempt, while a number of business purchases are taxed.

Final sales of most goods (personal property) and a limited number of services make up the tax base. Generally, goods are taxable unless specifically exempted and services are not taxable unless specifically included in the law. Improvements to real property are not taxable but purchases of construction materials are taxable. Sales of motor vehicles are exempt from the general sales tax in chapter 297A but subject to a comparable motor vehicle sales tax under chapter 297B.

A major share of the sales tax is paid by businesses rather than consumers. In theory, the sales tax is a tax on final consumption but the reality is that the tax is applied to a number of business purchases. According to the Department of Revenue's 2017 *Tax Incidence Study*, about 43 percent of the general and motor vehicle sales taxes are paid on purchases by business.

Tax base erosion and expansion may be used by the legislature for many reasons. For example, expansion of the tax base can used to overcome state fiscal crisis by repealing exemptions or expanding to include currently nontaxable goods and services. Both of these approaches generate revenue for the state without raising the tax rate. In 1987, when faced with a budget shortfall, the legislature expanded the sales tax base to include services such as

dry cleaning, lawn care services, and car washing among many other services.
Another reason the legislature may choose to expand the sales tax base is to adapt the law to changes in society. For example, digital products and downloads became taxable in 2013.

Overall, Minnesota has a narrow base and there are a number of goods and services that could be added to the tax base. With a broader tax base, the same revenue could be raised with a lower tax rate. The *Minnesota Tax Expenditure Budget,* authored by the Department of Revenue, contains a list of exempt goods and services with estimates of the revenue impact not taxing these items has on the state.

Exemptions

There has been a cumulative erosion of the tax base over time. When the tax was enacted in 1967 there were 14 exemptions in the exemption section of the statute (§ 297A.25). By 1990 there were 46 exemptions in § 297A.25 and other exemptions in separate sections or buried in definitions. The 2000 sales tax recodification effort identified 104 exemptions. There are currently exemptions to the tax base listed in statute, although a sizable number of these are exemptions of business purchases. Major sales tax exemptions include:

General exemptions:

- Food for home consumption
- Clothing
- Home heating fuels
- Motor fuels subject to the per gallon motor fuels tax
- All drugs for human consumption
- Newspapers and subscription magazines
- Cigarettes[4]

Business exemptions:

- Capital equipment
- Farm machinery
- Certain direct inputs to agricultural and industrial production
- Certain direct inputs for some taxable services
- Telecommunications equipment
- Construction exemptions for certain businesses and nonprofits

Exemptions for certain entities:

[4] When cigarettes where exempted from sales tax during the 2005 session, the tax was replaced with a per pack tax at the wholesale level. The per pack rate is 6.5 percent of the average retail price based on a survey. The survey is conducted every year. The tax can be found in Minn. Stat. § 297F.25. In comparison other tobacco transactions are subject to the general sales tax rate of 6.875 percent.

- Purchases by most local governments[5], the federal government and public libraries
- Purchase by local governments of marked public safety vehicles
- Firefighting equipment
- Selected other sales to local governments
- Purchases by nonprofit charitable organizations including hospitals
- Certain sales made by nonprofit organizations

The legislature has followed a policy of reducing sales taxes on business inputs. This decision is consistent with the theory that the sales tax should be a tax on final consumption. Taxing business inputs is a hidden tax on final consumption since the tax paid on inputs is built into the price of the final good or service. If the final product is also subject to the sales tax, a tax on inputs results in tax “pyramiding.”

External factors affecting the sales tax base

The economy has changed from a goods based to a service based economy. Services accounted for 42.1 percent of personal consumption expenditures in 1965. By 2023, that share had increased to 67.5 percent.[6] The sales tax base is growing at a slower rate than the total economy.

The Internet impacts the sales tax in multiple ways. Prior to 2018 the state could not require remote sellers to collect the state tax (see sales tax and remote sales below). Internet sales increased the amount of total remote sales and therefore increased the lost tax revenue. The Department of Revenue’s estimated the loss, for CY 2011, as $204 million with $149 million due to e-commerce and $55 million to catalog sales.[7] As described below, the taxability of internet sales has changed and the state no longer has lost revenue on internet sales.

Sales tax and remote sales

Beginning October 1, 2018, most remote sellers with more than a de minimis amount of sales must collect and remit Minnesota sales tax. A remote seller is a retailer that does not have a physical presence in a state. The June 2018 Supreme Court case *South Dakota v. Wayfair* allows states to require remote sellers to collect sales taxes if certain conditions are met.

This case essentially overturned two previous Supreme Court cases – *Bellas Hess* in 1967 and *Quill* in 1992. These older cases involved mail order companies who were the major remote sellers at that time. In *Quill*, which affirmed *Bellas Hess*, the court ruled that remote sellers did

---

[5] This exemption for school districts was expanded to include counties, cities, and townships in 2013. The exemption is expanded to include special taxing districts, except the Metropolitan Council, and all joint powers boards beginning January 1, 2016, and to the Metropolitan Council beginning January 1, 2017.

[6] U.S. Bureau of Economic Analysis, "Table 2.3.5. Personal Consumption Expenditures by Major Type of Product" (accessed Wednesday, December 4, 2024).

[7] This is the estimate loss of retail sales. A large share of the unpaid use taxes on business purchases are probably related to remote sales as well but are not included in this estimate.

not have to collect the sales tax because the sellers had no physical nexus to the taxing state and therefore the imposition of the tax placed an undue burden on interstate commerce. The court noted that the complexity of the different tax systems was too much of an administrative cost to business. The court also stated that Congress could take action to overturn the ruling legislatively but congress never acted.

Between 1992 and 2018 Minnesota took a number of actions to try to impose sales tax collection duties on remote sellers despite the Supreme Court ruling. Some of the legislative actions included:

- Not repealing our economic presence test similar to the North Dakota economic presence test that was ruled unconstitutional under *Quill (* instead adding language to the effect that *this was effective to the extent allowed under the U.S. constitution or federal law);*
- Passing a number of statutory provisions that attempt to establish that a company had a physical presence including “affiliate nexus,” “click through nexus,” and nexus based on use of an online “market place provider” with a physical presence in this state; and
- Joining the Streamlined Sales Tax Project (SSTP) and adopting the sales tax simplification provisions included in the Streamlined Sales and Use Tax Agreement (SSUTA) which is discussed in the box on the next page.

In *Wayfair,* the Supreme Court overturned the *Quill* physical presence rule and replaced it with an economic presence standard. The court then held that South Dakota’s economic presence nexus standard did not violate the U.S. dormant commerce clause because the significant economic and virtual contacts the respondent had with the state were sufficient to establish nexus with the state, thus allowing the state to impose the requirement to collect. (South Dakota had an exclusion from the collection requirement for remote sellers with minimal sales in the state (less than 100 transactions or $100,000 in sales in a year) which now essentially functions as a de facto threshold for economic nexus as states contemplate legislation in this area.) While the court remanded the case to determine whether other constitutional issues related to undue burden or discrimination could invalidate the law, they suggested that because South Dakota had taken a number of steps to reduce the burden of sales tax collection on remote sellers, the law would withstand further constitutional scrutiny. Some of the most important provisions cited by the court in this regard included:

- access for remote sellers to use of a free certified service provider (paid by the state) to facilitate the collection and remittance of the tax; and
- simplification and standardization of the administration practices, and definitions of items subject to the state sales tax.

These two items are requirements of all states that are members of SSUTA. As a member state we meet a number of the criteria for simplification cited in the court case. In addition, we already had in our statutes an exclusion for remote sellers with minimal sales into the state (although it differs slightly form the South Dakota exclusion). And our economic presence nexus provision was no longer unconstitutional. For those reasons the Minnesota Department

of Revenue administratively started to require collection and remittance of sales tax from remote sellers beginning with sales made after September 30, 2018. Our statue requiring Internet marketplace providers with a physical presence in the state to collect tax on sales made on their platforms also had a contingent date based on congressional action or the overturning of the *Quill* case so this provision also went into effect on October 1.

Although the state is now collecting sales tax on remote sales, the revenues gained may be lower than expected. This is for a number of reasons, including a number of Internet sellers (such as Amazon and Apple) already had a physical presence in the state and were already collecting the tax on many sales. Also, Revenue is trying to accommodate new remote sellers registering with the state by providing them with some flexibility as they set up their system to collect. Additionally, some "remote sales" continue to be exempt from Minnesota sales tax because of other exemptions in our system or because the sellers are exempt from collecting because they make minimal sales into the state.

As the state ramps up sales tax collection by remote sellers it is likely that there will need to be changes to the sales tax statutes to clarify how the law should be administered and to remove language that may be redundant.

History of the Streamlined Sales and Use Tax Agreement and Minnesota

In January 2000, states realized that they would have to develop their own agreement to simplify and coordinate state sales tax systems. This was necessary if there was to be any chance of congressional or court action to require remote sellers to collect the sales tax; therefore the Streamlined Sales Tax Project (SSTP) was initiated. The SSTP was a voluntary effort supported by the National Governor's Council (NGA), National Council of State Legislatures (NCSL), the FTA, and the National League of Cities (NLC) to develop an agreement to simplify tax administration and collection among states, and develop standard *definitions* to be used by all states in defining their sales tax base.

The final Streamlined Sales and Use Tax Agreement (SSUTA) was adopted by the project on November 12, 2002. It is constantly being amended to reflect input from businesses and other interested parties. Currently 24 states, including Minnesota, have adopted the required legislation and are full members of the SSUTA. Only member states are part of the governing board and may vote on changes to the agreement. The other states with a state sales tax act in an advisory capacity to the SSUTA governing Board.

Gross receipt taxes related to SSUTA. Minnesota was one of the first states to modify its sales tax law to conform to the agreement (mainly in the 2001 and 2002 sessions). One aspect of the agreement requires one tax rate on all taxable items except for sales of electricity, natural gas, or other heating fuels, and motor vehicles, aircraft, modular homes, manufactured homes, and mobile homes. The state could keep the separate rate on manufactured homes and rental cars but had to eliminate its sales tax rate of 9.0 percent on alcoholic beverages; therefore in 2005 the sales tax rate on alcoholic beverages was lowered to the general rate and a 2.5 percent gross receipts tax was enacted to replace the lost revenue.

Revenues associated with being a SSUTA member state. Prior to *Wayfair* a number of businesses came forward and voluntarily registered to collect the Minnesota sales tax, either directly with the state under its SSUTA amnesty provision, or through the SSUTA central registration system. The state was collecting more than $20 million annually from these voluntary registrants.

Advantages to remaining a member of SSUTA. South Dakota is also a member of SSUTA and the Supreme Court cited a number of SSUTA provisions in effect in that state as reasons why the imposition of the duty to collect sales tax on remote sellers in that state may not be an "undue burden on interstate commerce". If the state withdrew from the agreement it would likely still need to comply with many of its provisions. In addition SSUTA provides the state with access to service providers that are paid under contract arrangement with the SSUTA governing board to collect and remit sales tax to member states on behalf of remote sellers.

Local Sales Taxes

General local sales taxes

The term "general" local sales tax refers to taxes imposed at the local level (county, city, special taxing district, etc.) in which the rate applies to the same base as the state sales tax.

In 1971, the legislature prohibited local governments from imposing or increasing an income tax or a sales tax at the local level. See Minn. Stat. § 477A.016. Thus, all local sales taxes require legislative action to be imposed or modified via a special law or statute that supersedes the prohibition.

Section 297A.99 provides statutory requirements for the imposition and administration of general local sales taxes that are authorized by special law or other statute.

Common characteristics of general local sales taxes:

- Authorized to fund the following types of projects:
  - A specific "bricks and mortar" project of a single building or structure
  - Improvements to a single park or recreation area
  - Improvements to a contiguous trail
- Project must meet a regional significance requirement.
- Usually imposed at a 0.5 percent rate.
- The tax does not usually extend to motor vehicles, although many have an alternative flat $20 tax on motor vehicles sold by local dealers.
- The tax expires either when a certain amount of revenue has been raised or on a certain date.
- Require a local referendum at the next general election.
- Require the local government to issue an ordinance imposing the tax and file a certificate of local approval with the secretary of state's office.

County transportation taxes

Minn. Stat. § 297A.993 authorizes counties to impose two types of transportation taxes. A county may impose:

- a tax of up to 0.5 percent on all retail sales and uses occurring within the county (thus operates similar to a general local sales tax); and
- an excise tax of $20 per motor vehicle (new or used) purchased within the county.

The law allows counties to impose both or either of these taxes. The law also restricts the use of the revenue generated from these taxes to the payment of:

- capital costs of transportation projects or improvements and related facilities;
- capital or operating costs of transit projects or improvements and related facilities; and

- transit operating costs.

Because the authorization for these taxes is codified in statute, a county wishing to impose a new tax does not need to seek legislative approval. Instead, the tax may be imposed by resolution of the county board. Additionally, counties acting under a joint powers agreement may impose the tax in each county under the agreement with approval by each county board. The law requires the termination of these taxes once the authorized project is completed; however, termination is not required when the tax is imposed to fund transit operations or projects.

Metro regional sales taxes

In 2023, the legislature enacted two general local sales taxes that are imposed on transactions occurring within or into the seven-county metro area.

The 0.75 percent transportation tax provides funding for transit and transportation projects within the metro area. The 0.25 percent housing tax provides funding for housing initiatives within the metro area. The law does not specify a termination date for these taxes.

Special local sales taxes

The term “special” local sales tax refers to taxes imposed at the local level (county, city, special taxing district, etc.) in which the rate applies to only certain transactions occurring within or into the taxing jurisdiction. Examples of special local taxes include:

- Lodging taxes
- Food and beverage taxes
- Amusement taxes
- Admissions taxes

Lodging Taxes

Minn. Stat. § 469.190 provides cities with the authority to impose a local lodging tax of up to 3 percent on lodging occurring within the jurisdiction. Statute requires that the city use 95 percent of the proceeds of the tax to fund tourism promotion, while the remaining 5 percent may be used to cover the cost of administering the tax. A city may elect to collect the tax itself or elect to have the Department of Revenue collect the tax on its behalf. Any deviation from the statutorily allowed tax rate or use of tax proceeds requires legislative approval via special law.

Food and beverage taxes

Local governments do not have general statutory authority to impose food and beverage taxes and thus need legislative approval to impose one. Food and beverage taxes are typically imposed on the sales of prepared food and beverages sold at a restaurant or other place of refreshment within the taxing jurisdiction. Often, these taxes apply to alcoholic beverages as well.

Because there is no statutory authority for these taxes, the authorizing special law must specify the tax rate as well as the allowed uses of the proceeds of the tax. Traditionally these taxes fund have funded capital projects or ongoing operational costs of a new or existing facility, such as a convention center or other entertainment/recreation facility.

Amusement, entertainment, and admissions taxes

Local governments do not have general statutory authority to impose these taxes and thus need legislative approval to impose one. These taxes are similar and often interchangeable depending on the tax base or the thing the tax proceeds go to fund.

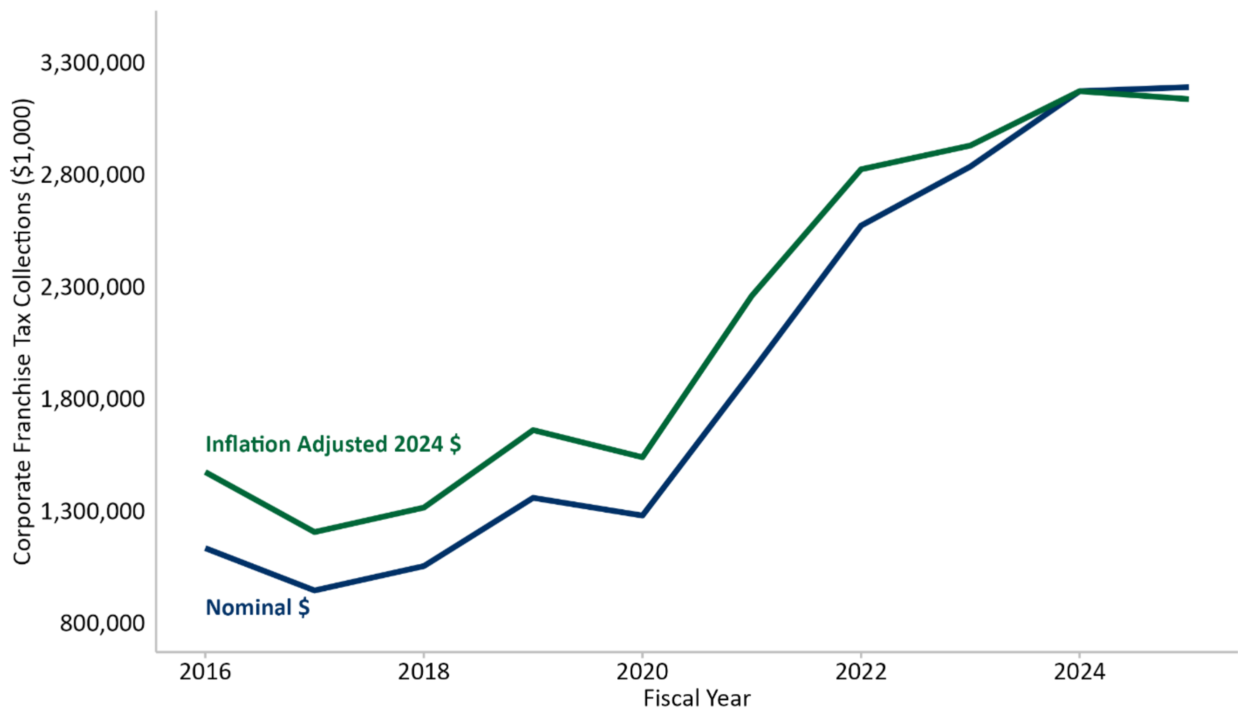
Amusement taxes are typically imposed on events related to recreation or entertainment activities, depending on the specificity of the authorizing special law. For example, this type of tax may be imposed on admissions to entertainment and recreational facilities as well as the rental of recreation equipment tied to the facility or activity.

Entertainment/admissions taxes may differ in that they apply only to admissions to entertainment events (i.e., concerts, sporting events, theatrical performances, etc.) rather than recreational activities.

Similar to food and beverage taxes, because there is no statutory authority to impose these taxes, the authorizing special law must specify the tax rate as well as the allowed uses of the proceeds of the tax. Typically, tax proceeds may fund capital or operational costs for new or existing recreation or entertainment venues.

More information: The Department of Revenue maintains a list of current local sales taxes and special local sales taxes on its website.

The Corporate Franchise Tax



The Basics

Tax base is net income of "C" corporations. The tax applies only to C corporations. S corporations, partnerships, limited liability companies, and other "pass-through entities" (such as RICs, REMICs, and REITs) are generally not subject to the corporate tax. Most base concepts roughly follow the federal income tax – federal depreciation rules are used and so forth. However, the state deviates on a number of items of modest importance, including (ranked based on revenue importance):

- Dividend received deduction (This deduction is intended to avoid taxing income to corporate entities more than once; federal law has a similar, but not identical, deduction.)
- Exemption for insurance companies (They pay a gross premiums tax instead.)
- The special temporary federal depreciation rules ("bonus depreciation") enacted in 2002, 2003, 2008 through 2017, and 2018 through 2026 do not apply.

Apportionment formula. For multi-state corporations, a state can constitutionally tax only income fairly attributable to the state. Thus, a method must be used to determine the income attributable to in-state activity. All states do this with an apportionment formula; traditionally a 3-factor formula (based on the in-state percentage of property, payroll, and sales) was used. Minnesota has used a heavily sales weighted formula for decades and starting in tax year 2014,

uses only sales (i.e., the percentage of the corporation's sales that are shipped or picked up by buyers in Minnesota). As noted below, most states now use sales only weighting, at least for manufacturers.

Combined reporting. For complex corporations (i.e., those with multiple corporations, such parent-subsidiary or brother-sister corporations), Minnesota uses a system of combined reporting for unitary businesses. This method requires each corporation in a unitary group to calculate its tax based on the total income of the unitary group, using its own sales as the numerator and the total group's sales as the denominator. This method prevents most transactions among related corporations in the unitary group from affecting the total tax liability of the group. State corporate taxes that do not use this method allow corporations to artificially shift income (e.g., through "transfer pricing" among the related corporations) to states in which income is lightly taxed or is not taxed at all. Minnesota has used combined reporting since 1982.

Tax rate

A **tax rate** of 9.8 percent applies to Minnesota taxable income.

Tax credits

Corporations are allowed various credits. These include:

Transit pass credit. Taxpayers may claim a credit equal to 30 percent for the cost of transit passes provided to their employees. The credit applies to the employer's subsidy in providing the passes (e.g., the difference between the cost that the employer incurs versus what it charges the employee). This credit is estimated to reduce revenues by less than $50,000 for FY 2021 for approximately 430 filers. In tax year 2023, about 30 returns claimed about $100,00 in credits.

Research credit. The 2010 legislature extended the longstanding research credit (often referred to as the research and development credit) under the corporate franchise tax to shareholders of S corporations and partnerships (including LLCs taxed as partnerships) subject to the individual income tax. (The credit does not apply to sole proprietors, though.) The 2010 legislation also made the credit refundable. The 2013 legislature eliminated the refundability of the credit, making it once again a nonrefundable credit. The credit's calculations are based on the similar federal credit, which applies to increases in expenditures for qualifying research over a base amount. The credit rate is 10 percent of the first $2 million of qualifying expenditures and 2.5 percent of the amount over that. Qualifying expenses are largely for cost of paying employees (and for their supplies) who are engaged in qualifying research. (Purchases of long-lived equipment does not qualify.) The estimated cost of credit for S corporations and partnerships in FY 2025 is $34.8 million; the estimated cost of the research credit for C-Corporations in FY 2025 is $115,200,000.

Credit for taxes paid to another state. This credit is intended to prevent the same corporate income from being taxed by Minnesota and another state. It applies in very few circumstances, since apportionment prevents most double taxation. The credit applies when another state

assigns income (rather than apportioning it) and Minnesota taxes the same income (either by assignment or apportionment).

Enterprise zone credits. These credits apply to certain activities in border city enterprise zones, if the credits are granted by the cities with the enterprise zones.

Historic structure rehabilitation credit. A refundable credit (provided in five annual, equal installments) is allowed equal to the comparable (nonrefundable) federal credit, effective beginning for tax year 2010. This credit expires July 1, 2031.

Film production credit. In 2021, the legislature enacted a credit for film production costs in Minnesota. Taxpayers must expend at least $1 million in a consecutive 12-month period to qualify. The credit is capped at $24.95 million per year and expires for tax years after 2030. The Department of Revenue estimates that ten taxpayers qualified for the credit in 2024 and that the credit will reduce revenues by $4.1 million in fiscal year 2025.

Minnesota housing tax credit. In 2021, the legislature enacted a credit for contributions made for housing projects administered by the Minnesota Housing Finance Agency. The credit is capped at $9.9 million per year and expires for tax years after 2028. The Department of Revenue estimates that the credit will reduce revenues by $3 million in tax year 2025.

Short line railroad modernization credit. In 2023, the legislature enacted a credit for certain railroad reconstruction and replacement expenditures. The credit sunsets for tax years after 2030.

Credit for sustainable aviation fuel. In 2023, the legislature enacted a credit for sustainable aviation fuel sold for aircraft departing from airports in Minnesota. The credit is capped at $7.4 million for fiscal year 2025 and $2.1 million for fiscal years 2026 and 2027.

Credit for sales of manufactured home parks to cooperatives. In 2023, the legislature allowed a tax credit to the sellers of manufactured home parks for park sales to manufactured home park cooperatives. The credit expires in tax year 2031.

Alternative minimum tax

An AMT applies under which corporations are required to compute their tax using a broader tax base (less generous depreciation allowances and so forth) and lower rate (5.8 percent). If the AMT is higher than the regular tax, the corporation must pay the AMT amount. Congress repealed the federal AMT in 2017 but imposed a new minimum tax in 2022. The state corporate AMT continues to be based on the repealed federal tax.

Minimum fee

This tax is not limited to C corporations, but also applies to S corporations and partnerships (in all of their various incarnations: regular partnerships, limited liability companies, limited liability partnerships, and so forth). The 2013 legislature increased the dollar amount of the fee and indexed it for inflation. The tax ranges from $250 to $11,570, depending upon the size of the

business measured by Minnesota property, payroll, and sales. The fee schedule for tax year 2024 is shown in the box below. The fee is an add-on minimum tax. A corporation pays the minimum fee, regardless of the amount of regular tax (or AMT) that is paid.

Tax Year 2024 Corporate Franchise Tax Minimum Fee Schedule

Property, Payroll and Sales	Fee
less than $1,220,000	0
$1,220,000 to $2,439,999	$250
$2,440,000 to $12,199,999	$730
$12,200,000 to $24,389,999	$22,440
$24,390,000 to $48,779,999	$4,890
$48,780,000 or more	$112,200

Revenues

Overview

The corporate franchise tax is a relatively minor source of state revenue. It is estimated to provide about 11.1 percent of nondedicated general fund revenues for FY 2024 (November 2024 forecast).

Amount

For fiscal year 2024, Minnesota Management and Budget estimates that the corporate franchise tax will raise $3.171 billion (November 2024 forecast).

Characteristics of revenues

- **Elasticity.** Revenues from the tax are elastic; they grow as the economy and corporate profits grow. However, increased use of pass-through entities and other factors such as international tax planning have dampened this effect.

- **Volatility.** Revenues from the corporate franchise tax are the most volatile of the major state tax sources. The table below provides examples of the effect of the 1981-82, 1990-92, 2001-02, and the 2007 to 2009 recessions on corporate tax revenues. As can be seen, for the 1981-82, 2001-02, and the 2007-09 recessions, revenues declined by one-third or more, and typically rebounded within two to four years to equal or exceed their prior levels. These numbers do not take into account inflation (high during the early 1980s) and that several legislative changes were made to increase revenues in 1981-82, 2006-2008, and 2013. In 2008, DOR estimated that legislated changes would raise corporate franchise revenue by about $90 million per year, making the FY2006 to FY2010 changes even larger, if the

comparison were made on a constant base. By contrast, 2002 revenues are slightly lower as a result of legislative changes (increasing the sales factor used in apportioning income). Legislative changes in 2023 also broadened the tax base (including global intangible low-taxed income in taxable income and lowering the dividend received deduction percentage) If anything, volatility appears to have increased in the last two decades, and has persisted through the COVID-19 pandemic. (Note—The 2023 fiscal year row in the chart below does not represent a peak, rather it is the last fiscal year for which revenues are available.)

Corporate Franchise Tax Revenues
Peak to Trough Change During Recessions

Fiscal Year	Revenues (millions)	Percent change
1980	$381.2	-33.3%
1983	254.3	
1985	380.4	+49.6%
1990	478.9	-12.2%
1992	420.3	
1996	701.7	+67.0%
2000	800.1	-33.8%
2002	529.5	
2006	1,061.6	+100.5%
2007	1,171.1	-43.3%
2010	663.5	
2019	1,660	+150.2%
2023	2,928.9	+85.3%
Source: MN Management & Budget		

Historical highlights

The tax was enacted in 1933 (at same time as the individual income tax) with graduated rates from 1 percent to 5 percent. These were the same as the individual income tax rates. As with the individual tax, federal tax was deductible. In 1937, the rates were converted to a flat rate of 7 percent.

In 1939, the legislature allowed manufacturing corporations to use sales weighted (70 percent) apportionment.

In 1953, the weighted apportionment option was extended to all corporations (not just manufacturers).

Over the years the legislature has changed the rate of the tax several times, imposed surtaxes, and adopted various minimum tax mechanisms.

In 1971, the federal income tax deduction was repealed and rates were raised to 12 percent. This was done to raise money to finance the "Minnesota Miracle."

In 1982, the research credit was enacted and combined reporting apportionment was adopted.

In 1987, the tax was significantly restructured in response to federal tax reform. This involved adopting the tax base expansions that were part of federal tax reform, requiring all taxpayers to use weighted apportionment, reducing the tax rate (9.5 percent), and adopting the "factors" minimum tax.

In 1988, the legislature enacted provisions granting preferential treatment to various types of foreign source income.

In 1990, the rate was increased from 9.5 percent to 9.8 percent.

In 1999, the legislature increased the sales weighting of the apportionment formula to 75 percent -12.5 percent -12.5 percent (effective tax year 2001).

In 2005, the legislature adopted an 8-year phase-in of 100 percent sales apportionment.

In 2008, the legislature rewrote the preferences for income received from foreign sources or by certain corporations with foreign operations, so these preferences were limited to income derived from foreign sources as provided under federal law.

In 2013, the legislature completely repealed the preference for foreign source income.

In 2017, the legislature changed the financial institution apportionment rules to include noncorporate entities and eliminated the corporate franchise tax exceptions for insurance companies that do not meet the federal definition of an insurance company or that are domiciled outside Minnesota.

In 2019, the legislature partially conformed to the federal TCJA and adopted a number of base-broadening provisions relating to the business interest deduction, net operating loss limits, and employer deduction limits, but did not adopt the base-broadener provisions relating to foreign income.

In 2020, the legislature fully conformed to federal section 179 expensing, effective for tax years beginning in 2020.

In 2023, the legislature broadened the corporate franchise tax base by repealing the state subtraction for global intangible low-taxed income (GILTI), lowering the dividend received deduction, and reducing the limit on the deduction for net operating losses.

Recent trends in policy changes to the tax

Minnesota

There have been some policy changes to the corporate franchise tax in the last decade, including the 2013 repeal of the preferences for certain forms of foreign income and operations, the adoption of TCJA base broadeners (other than the international provisions) in 2019, and the base broadening provisions in 2023. Major changes were made in response to federal tax reform (in 1986) and its aftermath. In the late 1980s and early 1990s, the minimum tax was restructured to eliminate the "factors tax."

Foreign source income provisions

In 1988, Minnesota adopted a series of interrelated provisions governing the taxing of foreign source income. These provisions were enacted in response to the adoption of combined (or unitary) reporting in 1982. These provisions essentially allowed certain qualifying domestic corporations ("Foreign Operating Corporations" or FOCs) to exclude 80 percent of their income from taxation. This was done on the theory that these corporations – which were intended to be primarily (defined at 80 percent) conducting foreign operations – would be afforded similar treatment to true foreign corporations. The law also allows exclusion of 80 percent of the foreign royalty and similar income paid by foreign corporations or FOCs. In 2005, the legislature modified the law to require FOCs to have substantial property (at least $2 million) and payroll ($1 million) in foreign countries to qualify. This was done to reduce the ease of shifting domestic source income into "shell" type corporations and qualifying for the reduced tax rates that apply to this income. A 2005 Minnesota Supreme Court decision made it clear that corporations that follow the required form under the law will qualify for the preferential tax treatment. In 2008, the legislature limited the preferential treatment for FOCs and for foreign royalty and similar to income meeting the rules defining foreign income for federal income tax purposes. In 2013, the legislature ended the explicit preference for foreign source income altogether.

The *de facto* preference for foreign source income (i.e., the ability of multinational corporations to use transfer pricing to shift income to tax haven countries to reduce their tax burdens) has become a federal and international issue for OECD (Organisation for Economic Co-operation and Development) countries. These techniques flow through to state corporate taxes that use waters-edge type combined reporting, as Minnesota and nearly all states do. Internationally, there is a movement to adopt anti-base erosion provisions cooperatively under what are known as the "Pillar Two" rules. In the United States, Congress adopted the base erosion anti-abuse tax (BEAT) and a tax on GILTI in 2017. The legislature initially did not conform to GILTI, but in 2023 repealed the state subtraction for this income, and now taxes GILTI as a dividend.

Other states

The general trend in other states is to increase the sales weighting of the apportionment formulas. Most states have gone to 100 percent sales apportionment for some or all types of businesses. Many separate reporting states have adopted provisions designed to minimize the

effect of tax avoidance structures used by multi-state corporations (in particular holding companies for intangibles that are based in Delaware or Nevada). These provisions typically disallow the deduction of expenses (e.g., payments to holding companies for intangibles that are intended to shift income to states where such income as not taxed – typically Delaware or Nevada). Many states have adopted combined reporting rules and combined reporting is under consideration in other states.

Alternate methods of corporate taxation

Taxes on corporate income are by no means the sole method of taxing corporations. Some states, such as Ohio and Washington, have gross receipts based taxes. These taxes are not as volatile as profits based taxes, but may result in pyramiding or multiple tax burdens. Like a sales tax on business inputs, they favor vertically integrated businesses. (In Minnesota, the Senate passed a VAT twice (in 1997 and 1998), not as a replacement for the franchise tax, but as a source of revenue to pay for property tax reform.)

Policy issues and perspectives on the tax

Tax falls unevenly on businesses

The tax applies only to C corporations. Businesses doing business in other forms (partnerships, S corporations, and so forth) are not taxable. C corporations tend to be larger businesses. Most publicly held corporations are C corporations. As a result, the tax becomes, in effect, a toll charge on being a public company with access to public securities markets. However, because so many publicly held companies are held by otherwise tax exempt investors (e.g., by foundations, pension funds, and foreigners or by other retirement accounts such as IRAs and 401k accounts), not all C corporate profits are subject to double taxation.

Tax incidence

The 2024 Tax Incidence Study (p. 104), prepared by the Department of Revenue, estimates that Minnesota consumers bear 77 percent of the tax, Minnesota labor 11 percent and Minnesota capital 12 percent. The study also notes that roughly 33 percent of the tax is exported.

Sales weighting and apportionment

In the 2005, the legislature enacted a governor’s recommendation to adopt an eight-year phase-in of 100 percent sales apportionment. The phase-in was completed in 2014.

Effects on different types of businesses

- 100 percent Minnesota businesses (those with 100 percent of their property, payroll, and sales located in Minnesota) are unaffected by the shift to sales based apportionment. They derive neither a benefit, nor experience higher taxes.

- Minnesota businesses whose Minnesota sales factor is lower than the average of the property and payroll factor received a tax cut. The larger the disparity, the bigger

the benefit. A classic example would be a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but which makes its sales nationwide (e.g., 3M or General Mills).

Businesses who have higher Minnesota sales factors and lower average Minnesota property and payroll have tax increases. The classic example is a national manufacturer of consumer products with few facilities in Minnesota (e.g., Proctor & Gamble or Microsoft).

Competitiveness effects

The principal argument for sales weighting is that it increases the state's competitiveness, i.e., it will help to attract investment or economic activity to the state, because it reduces the effective tax rate on new investment in plant and equipment. Put simply, because tax liability is unaffected by the presence of property or payroll, investing in a new or expanded plant or hiring additional employees has no effect on tax liability. Conversely, closing a plant or moving an office will not reduce tax liability, unless doing so totally severs ties with the state so that the business has no nexus (unclear whether just eliminating all property and payroll is sufficient to achieve that result). It should be noted however that an out-of-state business with sales in Minnesota could be discouraged from locating property and payroll in the state if doing so would create nexus between that business and the state, which would then increase its tax.

Incidence effects

Apportionment formula issues affect the incidence of the tax, i.e., the real people who actually pay the tax (consumers v. shareholders v. workers). Increasing the sales weighting generally will shift the incidence of the tax toward consumers. Using 100 percent sales weighting reduces competitiveness concerns, precisely because it makes the tax more like a sales tax/consumption tax. This is so because corporations will pay the tax based on their Minnesota sales, regardless of where their capital is located. This makes it much more likely that the tax will be passed along to consumers.

Cigarette and Tobacco Tax and Fees

Tax base

The tax is imposed on sales of cigarettes and tobacco products (cigars, pipe tobacco, chewing tobacco, snuff, synthetic nicotine, vapor products, etc.). The tax on cigarettes is imposed on a per unit base (i.e., per cigarette). Until 2017, this rate was adjusted annually for inflation in the average retail price of cigarette under a 2013 change in the law. The 2013 legislation also repealed the $.75-cent/pack health impact fee and increased the combined basic rate and old health impact fee rate by $1.60 per pack to $2.83/pack. When the annual inflation adjustment was repealed in 2017, the tax was set at $3.04/pack, which was then the rate in effect under the inflator. The tobacco products tax is a percentage of the wholesale price.

Tax rates

Cigarettes	$3.04/pack of 20
Tobacco Products	95 percent of wholesale price

Two exceptions apply to the 95 percent tax rate that applies to tobacco products:

- A minimum tax applies to each container of moist snuff equal to the tax rate on a pack of 20 cigarettes.
- Premium cigars (hand-rolled with a wholesale price of $2/cigar or more) are subject to a maximum tax of $0.50/cigar, which effectively imposes a tax of $0.50 on all premium cigars.

Nonsettlement cigarette fee

A special cigarette fee of 50 cents/pack applies to “nonsettlement cigarettes.” These are cigarettes produced by manufacturers other than the major companies that settled the liability lawsuits filed by the state or companies that voluntarily elect to participate and make annual payments (as approved by the Attorney General). This fee was enacted by the 2003 legislature at a 35-cent per pack rate and increased by the 2013 legislature to 50-cents per pack rate. By its terms, the fee was intended to compensate the state for costs attributable to the use of these cigarettes (similar to what settling companies are paying) and to deter youth smoking. The Minnesota Supreme Court upheld the constitutionality of the fee in a 2006 decision; the U.S. Supreme Court declined to review the case. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) *cert. denied* 549 U.S. 1052 (2006). Collections under this fee are not included in the collection numbers listed below.

Enforcement and collection

The cigarette tax is collected and enforced through a stamp mechanism. Each pack of cigarettes is required to be stamped with a tax stamp. Cigarette distributors apply these stamps with heat applied stamp machines, approved by the commissioner of revenue.

Revenue

Fiscal Year 2024 (in millions)	$517.9
Percent of Total State Tax Revenue	1.54%

Revenues from the tobacco products tax are deposited in the general fund. Cigarette tax revenues of $22.25 million/year go to fund the Academic Health Center, $3,788,000/year to the medical education and research account, and the rest to the state general fund.

Alcoholic Beverage Excise Taxes

Tax base

Tax is imposed on alcoholic beverages (beer, wine, and spirits) on a per unit of volume basis (i.e., gallon, liter, or barrel).

Tax rates

The rates vary by the type of beverage and, in the case of wine and beer, by the alcohol category in which the product falls. The rates are as follows:

Liquor (distilled spirits)	$5.03/gallon	$1.33/liter
Wine < 14% alcohol	$.30/gallon	$.08/liter
Wine > 14% but < 21%	$.95/gallon	$.25/liter
Wine > 21% but < 24%	$1.82/gallon	$.48/liter
Wine > 24%	$3.52/gallon	$.93/liter
Sparkling wine	$1.82/gallon	$.48/liter
Cider	$.15/gallon	$04/liter
Beer > 3.2% alcohol	$4.60/barrel*	
Beer < 3.2% alcohol	$2.40/barrel*	

* A barrel contains 31 gallons. Thus, the tax rates for beer on the basis of gallonage are $.15 for “strong beer” (3 cents for a 12 ounce beer) and $.08 for 3.2 beer (2 cents for a 12 ounce beer).

Exemptions

Only limited exemptions apply under the tax:

- Sacramental wine
- Product sold to food processors and pharmaceutical companies
- The first 25,000 barrels of beer produced by a brewery with annual production of less than 100,000 barrels (A barrel is 31 gallons.)
- The wine excise tax paid by small wineries (producing fewer than 75,000 gallons per year) on most wines
- The distilled spirits tax paid by a microdistillery on the first 100,000 liters of product sold

Collection

Tax is imposed on the manufacturer or licensed distributor of the beverage.

Comparison with other states

Minnesota's wine and beer excise taxes are average or below average compared with most other states. The table to the right compares Minnesota's tax with taxes in surrounding states. Minnesota's tax on distilled spirits is among the higher taxes for states with excise taxes. A number of states (including Iowa) have distilled spirits monopolies and a portion of the price markup is a *de facto* tax; it is difficult to compare the tax burden with these states. Minnesota also imposes a 2.5 percent gross receipts tax on sales of alcoholic beverages, in addition to the state sales tax. This additional tax replaced a higher sales tax rate and is discussed briefly in the sales tax section. Thus, the total Minnesota alcohol tax burden is higher than suggested by simply comparing excise tax burdens.

Excise Tax Rates (per gallon) Bordering States			
	Strong Beer	**Table Wine**	**Spirits**
IA	$.19	$1.75	N.A.
MN	**.15**	**.30**	**$5.03**
ND	.16	.50	2.50
SD	.27	.93	3.93
WI	.06	.25	3.25
Source: Federation of Tax Administrators			

Revenue

Fiscal Year 2024 (in millions) $111.4

Percent of Total State Tax Revenue 0.3%

The actual FY 2024 revenues by beverage type and for the gross receipts tax are shown in the table below.

Beverage Type	FY 2024 Revenues (000)	% of Total
Beer	$14,000	6.2%
Wine	7,200	3.2%
Distilled Spirits	91,300	40.1%
Excise tax total	112,500	49.4%
2.5% gross receipts tax	114,100	50.6%
Total	**$227,600**	
Source: MM November 2024 Forecast		

Cannabis Gross Receipts Tax

Cannabis legalization in Minnesota

In 2023, the legislature authorized the sale of recreational cannabis for adult consumption within the state. The law provided for imposition of a gross receipts tax on all sales of recreational use cannabis and cannabis products.

Tax rate, base, and deposit of proceeds

Minnesota imposes a gross receipts tax of 10 percent on the purchase of all cannabis products, including low-potency edibles and THC/cannabis infused beverages. Similar to the gross receipts tax imposed on alcoholic beverages, this gross receipts tax is imposed in addition to the state sales tax, as well as any local sales taxes that apply within the jurisdiction where the sale occurs.

The law exempts medical cannabis from the gross receipts tax and prohibits local governments from imposing local taxes solely on cannabis products.

Proceeds from the tax are split between the general fund (80 percent) and the local government cannabis aid account (20 percent).

Local government cannabis aid

Within the tax and regulatory framework, the legislature enacted an aid from the 20 percent portion of tax proceeds that are deposited into the local government cannabis aid account to help localities offset the costs of regulation and enforcement of cannabis legalization.

Beginning with aid payable in 2024, the total aid available statewide equals the balance in the local government cannabis aid account in the special revenue fund as of the close of the previous fiscal year.

Half of the aid will go to counties, and half will go to cities. Of the amount dedicated to counties, 20 percent of the aid is distributed to counties statewide and 80 percent is distributed to counties in proportion to the number of cannabis businesses located in the county. The amount dedicated to cities is distributed in proportion to the number of cannabis businesses located in the city.

Lawful Gambling Tax

Lawful gambling in Minnesota

Minnesota law authorizes nonprofit, charitable organizations to conduct the following types of gambling activities: pulltabs (electronic and paper), tipboards (including sports-themed), bingo (paper and electronic), paddle tickets, and raffles. Minnesota laws regarding the regulation of lawful gambling can be found in Minnesota Statutes, chapter 349.

Sports betting remains illegal in Minnesota. The Minnesota Legislature has not authorized legal sports betting in Minnesota despite the 2018 ruling by the U.S. Supreme Court in *Murphy v. National Collegiate Athletic Association*, that lifted the federal ban on states' administration of commercial sports betting. See *Murphy v. National Collegiate Athletic Ass'n*, 138 S. Ct. 1461 (2018).

Tax rates

Flat tax. A tax of 8.5 percent is imposed on an amount equal to the organization's gross receipts less prizes paid (or net receipts) from bingo (paper only), paddle tickets, and raffles. The rate does not vary based on an organization's receipts. Each month of the fiscal year beginning in July and ending in June, the organization calculates its receipts and remits tax owed to the Department of Revenue. Minn. Stat. § 297E.02, subd. 1.

Combined net receipts tax. This tax is imposed on lawful gambling activities not subject to the flat tax—pulltabs (paper and electronic), tipboards (excluding sport-themed tipboards), and bingo (electronic only). Like the flat tax, this tax is imposed and paid monthly. Minn. Stat. § 297E.02, subd. 6. However, unlike the flat tax, the rate of this tax is based on an organization's total annual net receipts and increases marginally as the annual net receipts exceed various thresholds, as shown in the following table:

Annual combined net receipts thresholds	Tax
$87,500 and under	8%
$87,501 - $122,500	$7,000 plus 17% of the amount between $87,500 and $122,500
$122,501 - $157,500	$12,950 plus 25% of the amount between $122,500 and $157,500
$157,501 and over	$21,700 plus 33.5% of the amount over $157,500

Each current month's liability is calculated based on the rate structure outlined above by taking the amount of the organization's net receipts from activities subject to this tax (plus interest and other income) and adding it to the previous months' net receipts to determine which of the graduated rates the organization should use to calculate its tax. The organization should multiply the corresponding rate by the difference between its current total net receipts and the maximum receipts from the tier below. Finally, the total amount of tax paid in the previous months of the fiscal year is subtracted from the amount owed in the current month so that the organization is not paying tax twice on the same total receipts.

Motor Vehicle Sales Tax

Tax rate and base

The motor vehicle sales tax is imposed on new and used motor vehicles at the time of sale. It is imposed in lieu of the general state sales tax on the sale price of motor vehicles, minus any trade-in allowance.

In 2023, the legislature increased the rate of the motor vehicle sales tax from 6.5 percent to 6.875 percent, which matches the general sales tax rate (including the constitutional amendment increase).

Revenue dedication

A constitutional amendment providing for the complete dedication of motor vehicle sales tax revenues to transportation and transit funding passed at the 2006 general election. The phased-in dedication was completed in FY 2012 and 100 percent of these revenues are dedicated to transportation and transit funding.

The constitutional amendment required that "no more than 60 percent" of the dedicated revenue go to the highway user trust distribution fund (HUTDF), and "not less than 40 percent" go towards public transit assistance (Minn. Const. art. XIV, § 13). The allocation of revenues is a follows:

- 60 percent to the highway user tax distribution fund;
- 34.3 percent to the metropolitan area transit account; and
- 5.7 percent to the greater Minnesota transit account.

Motor Vehicle Fuels Tax

Tax base

There are three main motor vehicle fuels taxes: the gasoline tax, the special fuels tax, and the aviation tax. The gasoline tax is imposed on all motor fuels used by vehicles on the public highways and on marine gasoline. The special fuels tax is imposed on propane and liquefied or compressed natural gas used by licensed motor vehicles. The aviation tax applies to aviation gasoline and jet fuel.

Exemptions

Motor fuels used by public transit systems receiving state financial assistance are exempt, as are fuels used by providers of transportation services for certain recipients of medical assistance, ambulance services, and certain providers of medical and dental services.

Tax rates

Highway motor fuels are taxed at a basic rate of 0.285 per gallon. An additional **debt service surcharge** applies at $.0035 per gallon (the maximum amount under a variable rate which has applied since 7/1/2012). Thus, the total rate is 31.8 cents per gallon. This rate includes the inflation factor described below.

In 2023, the legislature established indexing on the motor fuels tax imposed on gasoline, E85, and M85, which requires an annual adjustment to each tax base rate that is based on increases in the Minnesota Highway Construction Cost Index. The adjusted rate must be calculated each August 1st and goes into effect the following January 1st for the next 12 months.

Starting in 2025, the annual percentage change in tax rate is capped at 3 percent. Prior to this, in 2008, the legislature provided for a phased-in increase in the motor fuels tax. The tax increased from 20 cents per gallon on April 1, 2008, phasing in over ensuing years to 28.5 cents per gallon on July 1, 2012 (which includes a 3.5 cents per gallon surcharge tied to trunk highway bonding).

Special fuels are subject to an excise tax. Propane is taxed at the rate of 18.75 cents per gallon. Liquified natural gas is taxed at the rate of 15 cents per gallon while compressed natural gas is taxed at the rate of $1.974 per thousand cubic feet (or 25 cents per gasoline equivalent).

Aviation fuels are subject to an excise tax. Aviation gas is subject to a rate of 5 cents per gallon. Jet fuel is subject to a rate of 15 cents per gallon. However, airlines are subject to tax at lower graduated rates on their purchases. The graduated rates are provided through a refund system.

Number of Gallons Used During Calendar Year	Tax Rate
0 - 50,000	$.05/gal
50,001 - 150,000	$.02/gal

150,001 - 200,000	$.01/gal
200,001+	$.005/gal

Revenue

	FY204 Revenues (millions)	% of Total State Tax Revenue
Highway Fuels	$886.5	2.6%
Aviation Fuels	6.1	< 0.1%

As required by the Minnesota Constitution, revenues from highway fuels are deposited in the Highway User Tax Distribution Fund. Moneys in this fund are used to pay for state trunk highways (62 percent), county state aid streets (29 percent), and municipal state aid streets (9 percent). Revenues from the aviation fuels tax are deposited in the State Airports Fund.

Motor Vehicle Registration Tax

The motor vehicle registration tax is imposed annually on each motor vehicle registered in Minnesota.

Tax base

Tax base consists of the base value of the passenger vehicles (plus a minimum amount) and minimums or weight based fees for commercial vehicles.

Tax applies only to vehicles using the public highways.

Base value is determined from the manufacturer's suggested retail price, using a statutory depreciation schedule. Accessories and optional equipment are generally not included in the base value.

Exemptions

Exemptions include vehicles owned by governmental units, school buses, ambulances, fire vehicles, and so forth. Exempt vehicles are required to have exempt registration plates.

Tax rate

The tax on passenger cars, pickup trucks, and vans is equal to a $10 flat amount, plus an additional 1.575 percent of the vehicle's age and original value. However, the tax cannot be less than $35. For commercial and other types of vehicles, the tax is based on weight and age.

In 2020, the tax rate started at 1.25 percent of the vehicle's original value. The rate decreased with vehicle age, and for older vehicles it shifted to a minimum $25 flat tax. The legislature made significant changes to the motor vehicle registration tax in 2023, reflected in the paragraph above.

The tax on trucks and buses is based upon the type, weight, and age of the vehicle. A minimum tax applies to each type of vehicle. There is also a flat tax on motorcycles and mopeds. The tax is paid when the vehicle is first registered in Minnesota to use the public streets and annually thereafter when it is re-registered.

Revenue

Fiscal year 2024 (in millions)	$903.3
Percent of Total State Tax Revenue	2.6%

As required by the Minnesota Constitution, revenues are deposited in the Highway User Tax Distribution Fund. Moneys in this fund are used to pay for state trunk highways (60 percent), county state aid streets (31 percent), and municipal state aid streets (9 percent).

The Provider Tax

Tax base

The provider tax is a series of gross revenues taxes on most health care products and services. All health care providers, including hospitals, physicians, chiropractors, psychologists, and dentists, are subject to tax. The tax on legend drugs, however, is imposed at the wholesale level, rather than on retailers. Deductions are allowed for certain types of medical research performed by nonprofit health care providers.

Exemptions

Exemptions include revenues from Medicare and the federal employees health benefits program. Nursing home and home health care services are generally exempt from taxation.

Tax rates

The tax rate is 1.8 percent for 2024. The law provides for contingent reduction in the tax rates, if certain conditions are met (ratio of revenue to expenditures from the fund and cash balances).

Special features

The law authorizes providers to "pass-through" the tax to third party payors, such as insurance companies and health maintenance organizations. This permits providers to shift the burden of the tax (as would be expected generally by economic principles), even if otherwise binding contracts with their purchasers prohibited it. The tax also provides a limited research credit for certain institutions.

Revenues

Fiscal year 2024 (in millions)	$751.1
Percent of Total State Tax Revenue	2.2%

Dedication of revenues

Revenues from these taxes are deposited in the health care access fund and used to pay for portions of the cost of both the Medical Assistance and MinnesotaCare programs. The fund also pays for various agency responsibilities including administering MinnesotaCare and granting resources to entities that enhance public health activities.

Insurance Premiums Tax

Tax base

The tax is imposed on gross insurance premiums (less return premiums). Various offsets to this tax are allowed, including four credits allowed under the individual income and corporate franchise taxes: the historic structure rehabilitation credit; film production credit; Minnesota housing credit; and short line railroad infrastructure modernization credit.

Exemptions

All reinsurance and insurance provided by fraternal benefit societies is exempt.

Tax rate

The basic tax rate is 2 percent. Mutual insurance companies with assets of $1.6 billion or less (on 12-31-89) pay 1.26 percent on their property and casualty premiums. Town and farmers' mutual companies and mutual companies with $5 million or less in assets pay 1 percent. The tax rate for life insurance is 1.5 percent. Higher rates may be imposed on out-of-state insurers under the retaliatory tax (see below).

Nonprofit health service corporations (such as Blue Cross) and health maintenance organizations (HMOs) pay at a 1 percent rate. The proceeds of the tax on these companies are deposited in the health care access fund.

A fire safety surcharge applies to homeowners, commercial fire, and commercial non-liability multi-peril policies. The surcharge replaced the old fire marshal tax. The rate is generally 0.65 percent (0.5 percent for some mutual insurance companies). The replacement of the tax with a surcharge was intended to prevent other states from using the tax in computing their retaliatory taxes. A firefighters' relief surcharge of 2 percent is placed on fire insurance written on property located in first class cities.

A $1 per vehicle per year surcharge applies to comprehensive auto insurance (the surcharge is levy at a rate of 50 cents per 6-month period). The proceeds of this surcharge are deposited in the auto theft prevent account.

Retaliatory tax

A "retaliatory tax" provides that out-of-state insurance companies are taxed at the higher of (1) the regular premiums tax or (2) the tax that the company's state of domicile (where its home office is located) imposes on Minnesota companies. This tax does not apply if the state of domicile does not have a retaliatory tax or has a reciprocal nonretaliation law.

Revenue

Fiscal Year 2024 (in millions)	$701.2
Percent of Total State Tax Revenue	2.0%

Mortgage Registry Tax

Tax base

Tax is imposed on the principal debt, which is secured by a mortgage of real property in the state.

Exemptions

The various exemptions apply. These include:

- Marriage dissolution decrees
- Mortgages to acquire or improve agricultural use real property
- Contracts for deed
- Mortgages under low and moderate income housing programs operated by federal, state, and local governments
- Mortgages to correct a legal description for the property

Rate

The rate is 0.23 percent of the principal debt.

Collection

The lender who records or registers the mortgage of real property pays the county treasurer in which the land is located, pays the tax at the time of recording the mortgage. The law imposes the legal incidence of the tax, however, on the borrower or the mortgagor.

Revenue

Fiscal Year 2024 (in millions) Total	$100.3
Disposition	
State General Fund (97%)	$97.4
County Revenue Fund (3%)	$3.0
Percent of Total State Tax Revenue	0.3%

Deed Transfer Tax

Tax base

Tax is imposed when real estate is transferred by any deed, instrument, or writing.

Exemptions

Various exemptions apply, including:

- Executory contracts
- Mortgages, mortgage satisfactions, and so forth
- Wills
- Plats
- Leases
- Deeds of distributions by personal representatives
- Deeds for cemetery lots
- Deeds conveying permanent school lands
- Certificates of sales or redemptions in foreclosures
- Marriage dissolution decrees

Tax rates

The rate is 0.33 percent of the consideration with a minimum tax of $1.65.

Collection

The county treasurer in the county where the land is located collects the tax. The tax is paid when the deed is recorded (generally by the owner of the property).

Revenue

Fiscal Year 2024 (in millions) Total	$143.1
Disposition	
State General Fund (97%)	$138.8
County Revenue Fund (3%)	$4.3
Percent of Total State Tax Revenue	0.4%

Estate Tax

Tax base

The estate tax is imposed on the taxable value of the estate. This is determined under the rules that apply under the federal estate tax. It generally means the fair market value on the date of death after deducting debts, funeral costs, and the cost of administering the estate. Special rules can apply in setting the value in limited circumstances – in particular for farmland and small businesses if the personal representative and certain of the heirs elect. Transfers to a surviving spouse are deducted from the value of the estate. Thus, no tax applies if all of the estate (over the exemption amount) is left to the spouse. In additions, bequests to charities are deducted.

The value of taxable gifts (i.e., the amount of gifts made to a recipient in a calendar year over the annual federal exemption amount, currently $19,000 for 2025) made within three years of the decedent's death are also added to the value of the taxable estate. Federal law includes, which Minnesota law follows, the amount of any federal gift tax paid on those gifts in the estate. (The gifts themselves are not included in the federal estate because federal gift tax applied or the gift reduced the joint exclusion amount available under the federal estate and gift taxes.)

Exemption

Prior to 2014, Minnesota had a *de facto* exemption of $1 million, based on a reference to the state death tax credit under prior federal law. Because of the manner in which the reference to old federal law was calculated, the $1 million amount did not function as a true exemption. Under 2014 legislation, a Minnesota-specific exemption (or true exemption) was provided, starting at $1.2 million for 2014 deaths and increasing in annual steps of $200,000 until it reached to $2 million by 2018. Yet in 2017, the legislature modified the exemption, increasing the amount that is exempt from the estate tax to $3 million in steps by 2020. By comparison, the federal estate tax provides an exemption amount of $14 million for deaths in 2025. The federal exemption amount is indexed for inflation and is "portable," that is, the surviving spouse inherits or can use the amount of federal exemption (exclusion) that was not used on the death of the first spouse. Congress doubled the amount of the exemption in the TCJA, but this provision will sunset in 2026.

The 2011 legislature enacted exemptions for qualified small business property and qualified farmland. These additional exemptions were effective for decedents dying after June 30, 2011, and are capped, in combination, at an amount that when added to the basic exemption equals $5 million for an estate. A variety of special qualifying rules apply to the decedent's use of the property and its nature. In addition, the property must pass to a qualified heir (family member) who continuously uses the property in a businesses or holds it as homestead agricultural property for three years. A recapture tax applies if the heir does not meet these requirements.

Tax rates

The 2017 legislation also enacted new Minnesota rate schedules due to the conversion of the exemption from a zero bracket amount (in the rate structure) to an exclusion or exemption that is deducted in computing the Minnesota taxable estate. For estates of decedents dying in 2018 and thereafter, the rates range from 13 percent to 16 percent; the top rate applies to estates with values of $10.1 million or more.

Relationship to federal tax

For the 16 years ending December 31, 2001, the Minnesota estate tax was directly linked to the federal tax as a "pick-up" or "soak-up" tax equal to the credit allowed under federal estate tax for state death taxes. As a pick-up tax, the Minnesota tax imposed no additional tax burden on estates. For each dollar of state tax paid, federal tax was reduced by an equal amount. However, Congress phased out this credit in 2001. For decedents dying after December 31, 2004, the credit no longer applies. However, as noted above, many of the federal estate's definitions and rules apply by reference to the Minnesota estate tax.

Revenues

Fiscal Year 2024 (in millions)	$285.9
Percent of Total State Tax Revenue	0.8%

Revenues from the estate tax are deposited in the general fund. Revenues from the tax are very volatile, since they depend on the deaths of a few individuals. If one very wealthy individual dies, collections can soar. For example, in August 2005, the Department of Revenue received a tax payment for one estate of $112 million (total collections for FY 2006 were $216 million compared with total collections for FY 2005 of $72.7 million). In other years, revenues may fall below estimates.

Other states – effect of repeal of federal credit

The repeal of the federal credit for state death taxes has changed the dynamics of state estate taxes considerably. When Minnesota imposed only a pick-up tax, the federal treasury paid the effective burden of the tax. As a result, Minnesota residents had no reason to change their domiciles to another state to avoid the Minnesota tax. Repeal of the federal credit makes the state tax a "real" tax that reduces the amount of money and other property that can be left to heirs. As of 2024, only 17 states plus the District of Colombia impose estate or inheritance taxes. Iowa's inheritance tax will fully phase out in 2025.

Light shaded states have estate taxes, darker shaded states have inheritance taxes, and the darkest shaded states have both taxes. New Jersey estate tax was repealed starting for 2018 deaths, leaving the state with only an inheritance tax.