

SALES AND USE TAX

ISSUE

How should Minnesota change its sales tax base, rate or administration?

POLICY

Minnesota's sales tax should be a retail sales tax levied on the final consumption of goods or services. Taxing goods and services on a basis other than final consumption violates the principles of equity, efficiency, ease of administration and accountability. To that end, PIM supports eliminating the sales tax on all intermediate goods and services. Due to the fiscal impact on the state, this change must be implemented over time. The Legislature should start with the following changes to the sales tax base:

- **Converting the capital equipment refund program to an up-front exemption.** The current refund program is an administrative burden to businesses, and to the Department of Revenue. It is also a cash-flow problem for small businesses.
- **Enacting an exemption for purchases made by non-manufacturers such as computer equipment.** Most non-manufacturers do not benefit from the capital equipment exemption. Enacting an exemption for non-manufacturers will give sales tax relief to an important segment of Minnesota's economy.
- **Exempting purchases of equipment that is used to comply with state or federal law (i.e. pollution control equipment, equipment required to meet safety regulations, etc.).** Doing so would make it less expensive to comply with state or federal requirements.

PIM does not support broadening the sales tax base to generate additional revenue. If the sales tax base is broadened to additional consumer goods or services, business inputs should be eliminated from the base or the rate should be reduced to make the change revenue neutral. PIM opposes broadening the sales tax base to business services and business-to-business transactions.

PIM supports repealing the June accelerated sales and excise tax payments. The accelerated payment requires businesses to estimate their June sales tax liability and remit a portion of it in June (current fiscal year), rather than the regular procedure of waiting until the June sales tax liability is known and remitting it in August (next fiscal year). The June accelerated payment is an administrative burden and added expense for businesses, and the Department of Revenue. Until this provision is repealed, PIM supports requiring the state to pay interest on the June accelerated tax payments. Once repealed, the Legislature should not use accelerated sales and excise tax payments as a future budget-balancing strategy.

Legislative Position

BUSINESS IMPACT

According to the Department of Revenue, businesses pay about 45 percent of state sales tax revenues. This makes the sales tax one of Minnesota's largest business taxes. The sales tax base, rate and administration affect business in a variety of ways.

- **Sales tax base:** Converting the capital equipment refund program to an up-front exemption simplifies administration of the tax and reduces compliance costs. It also helps small employers because they no longer will have to finance the tax themselves and it provides sales tax relief to those businesses that do not know about the refund program. Eliminating the sales tax on purchases made by non-manufacturers will provide sales tax relief to those businesses in many of Minnesota's fastest growing industries. These companies did not see the benefit of previous capital equipment legislation. Applying the sales tax to business services or other business-to-business transactions penalizes companies that choose to contract for services rather than having them performed "in house." It penalizes service providers by giving an incentive for Minnesota's largest employers to have the services performed outside of the state or in-house.

Making progress reforming the sales tax base is important because it will become increasingly difficult to do so if the trend continues of granting local government's sales tax authority. As more local projects become dependent on sales tax revenue for financing, local governments will likely become opponents of eliminating business inputs from the sales tax base and proponents of expanding the sales tax base to business services.

- **Sales tax rate:** Since businesses pay about 45 percent of the state's sales tax, a sales tax rate increase would be a significant business tax increase. A reduced sales tax rate, accompanied by an expanded sales tax base, will change the incidence of the sales tax. The impact on business will depend on what new goods and services are taxed. Base expansion has the potential to increase the stability of the sales tax and reduce its regressivity.
- **Sales tax administration:** Repealing the June accelerated sales tax payment will ease business' administrative burden. Enacting new gross receipts taxes rather than eliminating "boutique taxes" could increase the administrative burden of Minnesota's tax system.