FISCAL FOCUS

MINNESOTA CENTER for Fiscal Excellence

Sound tax policy. Efficient spending. Accountable government.

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In This Issue:

Taxes and Their Replacement

Heading into the homestretch a look at where the House and Senate tax bills overlap and why the American Rescue Plan is an afterthought in building a budget.

If one only considers the numbers, there would seem to be some cause for optimism for a timely resolution to the 2021 session. We have a $1.6 billion surplus – very much on par with past biennial budget sessions — and a healthy budget reserve. MMB reports general fund revenue collections are up $563 million through March from a February forecast that was released just 30 days earlier. Meanwhile, thanks to the federal government, about $6.3 billion is now showing up in Minnesotans' bank accounts. Another $8 billion of additional federal COVID recovery relief is on the way to help juice the economy. We are currently projected to have a surplus of $940 million to end the current fiscal year. Smart money would take the over.

But politics, not numbers, dictate the outcome. Divided government is once again generating budget and tax proposals reflecting two profoundly different perspectives on the state of state government. If lawmakers can't reach an agreement, it would be the fourth consecutive biennial budget session to require a special session. The constitutional deadline is May 17. Smart money would likely take the over on that too.

A Look at the Common Ground

The Senate has now passed its omnibus tax bill setting the stage for the tax conference committee. As expected, it is much more modest in both its taxing and tax relief ambitions than the House counterpart. The out-biennium tells the tale – a $1.2 billion difference in general fund impact. Over three-quarters of the Senate's FY 22-23 total revenue impact of $533 million comes from a single provision – full (uncapped) conformity with federal exclusion of PPP loans from income, largely a one-time hit. Most significantly it holds true to the Senate's no new taxes commitment.

For legislative bodies that seem have little in common on tax matters, there are some notable areas of agreement. Table 1 (page 2) captures the extent of shared provisions between them.

Notably absent from the Senate bill is federal conformity pertaining to the all the other federal COVID response acts and federal extenders. The tab for full conformity across these other federal acts (excluding a few specific areas of purposeful decoupling) is around an additional $143 million. The difference between the Senate and House PPP conformity proposals is $168 million. Thus, full federal conformity could be paid for by the House's capped subtraction.

That is worth noting because in all the discussion and press coverage surrounding PPP something has largely escaped recognition. By excluding both the loan income and the expenses paid with the loan income, an extra benefit is provided to any businesses who were fortunate enough to have received a PPP loan but also had other income on which they had to pay tax. How often this occurred is not known. But conforming does create an implicit tax fairness issue compared to an identical company that didn't receive a loan but had to reduce expenses or spent down working capital to avoid laying off workers. A numerical cap doesn't address this problem since 2020 profitability isn't necessarily related to the size of forgivable loans. But capping it would pay for a lot of other important and beneficial business conformity actions.

An $8 Billion Non-Factor

According to MMB, Minnesota is expected to receive $7.955 billion from the latest infusion of federal recovery aid, the American Rescue Plan (ARP). The eagerly anticipated and more "flexible" pot of money in the plan— state and local recovery funds – totals $4.881 billion of which $2.577 billion goes to the state[1] and the remainder to city, county, and other local units of government. The remaining difference goes to 27 specific spending areas headlined by $1.32 billion to Minnesota elementary and secondary schools.

Although such revenues might be expected to influence on tax committee thinking and budget making in general, ARP has only been an occasional talking point on the need (or not) for more money. That's because the distribution of these funds is almost assuredly to be handled by the Governor alone outside of the budget development process and after the session adjournment date. The fact that the legislature only serves in an advisory capacity on federal funds under current law has been a sore spot among lawmakers. Now billions loom on the horizon for the Governor to spend as he sees fit. It's theoretically possible that in the remaining weeks the House, Senate, and the Governor could come to a deal on some of this spend-

[1] The state also receives an additional $179 million specifically for water, sewer, or broadband capital investments.

Minnesota Center for Fiscal Excellence

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Table 1: House/Senate "Areas of Common Ground" Tax Provisions ($000)

Item	General Fund Impact	
	FY 2022-2023	
Federal Conformity and Updates	**House**	**Senate**
Forgiven PPP Loans Individual Income Exclusion*	(127,300)	(209,700)
Forgiven PPP Loans Corporate Franchise Exclusion*	(113,300)	(199,400)
Educator Expense Deduction for Personal Protection Equipment	(40)	(25)
Section 179 Expensing, Individual Income for Carryover Properties	(2,800)	(2,800)
Section 179 Expensing, Corporate Franchise for Carryover Properties	(1,000)	(1,000)
Income and Corporate Franchise Taxes		
Pass-Through Entity Tax and Credit to Avoid Federal SALT Cap	—	—
Angel Tax Credit Extended (Tax Year 2022 Only)	(10,000)	(10,000)
Partnership Audit Rules Based on the Multistate Tax Commission Model	(2,000)	(2,000)
Pandemic Unemployment Benefit Subtraction**	(234,800)	(28,400)
Historic Rehabilitation Credit***	(19,300)	(5,200)
Sales and Use Taxes		
Exempt COVID-19 PPE Expenses by Restaurants	(9,450)	(9,450)
Exempt Public Safety Facility Construction	(6,120)	(6,120)
Exempt Purchases for K-12 School Fundraising	(1,310)	(1,310)
Authorize Local Sales Taxes – Carlton County, Itasca County, Mille Lacs County, Cloquet, Edina, Fergus Falls, Hermantown, Litchfield, Little Falls, Moorhead, Oakdale, St. Cloud, St. Peter, Wadena, Waite Park	—	—
Property Taxes		
Statewide Property Tax – Increase Exclusion from $100,00 to $150,000	(30,750)	(30,750)
Statewide Property Tax – Exempt Tribal Land (Refund)	(20)	(20)
Agriculture Market Value Credit – Expanded Determination	—	—
Authorize Creation of Local Fire/EMS Taxing Districts in General Law	—	—
Tax Increment Financing (TIF) Special Laws – Bloomington, Burnsville, Mountain Lake, Wayzata, Windom	—	—
Tobacco Taxes		
Dedication of Cigarette Taxes to Prevention and Cessation****	(30,000)	(5,000)
TOTAL	**(588,190)**	**(511,175)**

** The House provision caps the subtraction at $350,000; the Senate has no cap.
** The House subtracts benefits up to $10,200 to $150,000 AGI; the Senate subtracts 18% of the federal benefit.
*** The House extends the credit until 2029; the Senates extends 1 year (2022) and caps the allocation at $14 million.
**** The House dedicates $15 million per year; the Senate is a $5 million one-time appropriation.

ing as part of a budget agreement. However, that would undoubtedly require some form of acquiescence on each sides' most valued positions – change to emergency powers/ Legislative Advisory Commission law on one side and the no new taxes commitment on the other, which is not going to happen.

Even if it did, ARP's inclusion in the budget development process would be compromised by the lack of federal guidance. In late March MMB reported that necessary Treasury guidance for the use of state and local recovery funds was not available and was not expected to be available for several weeks. Of particular concern is the interpretation of a provision preventing states from using the funds "to either directly or indirectly offset a reduction in the net tax revenue." It is now been several weeks and the only guidance issued from Treasury has been to declare the use of relief to pay for conformity actions are permissible under this offset provision. It's not clear to us if any state tax cuts would jeopardize state recovery funds on a dollar-for-dollar basis or the whole appropriation. Assuming the former and based on our review of the House and Senate tax bills, conservatively $269 million in federal aid could be forfeited by adopting the full suite of tax credits, exemptions, and exclusions in the omnibus bills. Further guidance is not expected until after adjournment.

The knowledge that recovery funds are coming may be having some indirect impact in state finance areas where there is a clear, but currently unquantifiable, substitution effect. For example, neither the House or the Senate bills include a general LGA increase which we might suspect was influenced by the knowledge that a significant tranche of federal support is forthcoming to cities and counties to replace lost revenues and fund different types of service delivery.

But with federal aid functionally on the sidelines at present, each side deeply rooted into their historical positions (lots of taxes on the wealthy and big business vs. no new taxes, period) and the opportunity for non-budget issues like police reform to hold the budget hostage, we have all the makings of a messy, contentious, and frenetic end culminating in intimate backroom negotiations among the triumvirate. In other words, the usual Minnesota finish. ■

Racial Inequity and the Tax Code

As lawmakers push to address racial inequities in government policy, we look at why tax policy presents a unique challenge and how Minnesota compares in one area that's received national attention.

Last month the House Tax Committee heard a bill to enhance the state's beginning farmers tax credit. The credit had a very modest budget impact and featured significant bipartisan support, all of which normally means a couple minutes of uneventful discussion. Yet the bill prompted one of the testiest and emotionally-charged moments we have ever witnessed in a legislative hearing. It was triggered by a small carve out specifically designed to improve credit access to people of color, indigenous communities, and immigrants to start farms. There was no controversy over the inclusion of this provision itself. However, in advocating for the bill, a testifier linked this provision to the ongoing need to correct for centuries of systemic and structural racism. This prompted a member to comment such remarks were an unnecessary issue to interject as part of the bill's consideration. That in turn prompted rebuttals for the need for people to come to grips with the history of structural racism in government policy which further devolved into a brief exchange on accusations of lecturing.

Given the events and circumstances of the past year, this moment perhaps shouldn't have been too surprising - especially with the added stresses of a budget session. Sensitivities and defenses are heightened and emotions are raw. The Walz administration has emphasized addressing racial inequality and injustice in all his budget and policy initiatives this session. As a result, every area of public policy has come under greater scrutiny as to how various provisions and their administration may reflect racial bias and foster inequity. Tax policy was not going to escape introspection.

The Data Problem

Gaining a greater understanding of if, how, and to what extent racial inequality exists in our tax code is challenging for a significant reason: IRS data is colorblind. As a recent tax law review article[2] noted, "Not only does the 1040 not ask about race, but the IRS Statistics of Income Division, the Treasury Office of Tax Analysis, and the Joint Committee on Taxation do not include race or ethnicity in their tax data analysis, forgoing the imputation or matching techniques that could reveal race and ethnicity even if the underlying data was colorblind." This is in stark contrast to other areas of government policy where a plethora of race and ethnicity information is available to inform policy analysis. It continues:

> *Citizens who want to know more about equal access to education can go to the Department of Education to look up higher education and enrollment by race, but if they go to Treasury to look up participation in tax preferred college savings accounts, they are out of luck…. A Senator concerned about equal access to affordable housing can look up Section 8 utilization by race, yet when consulting with Joint Committee on Taxation for reforming the mortgage interest deduction, race and ethnicity are absent from the analysis.*

There is no law preventing this; it just hasn't been part of tax data administration since the passage of the Revenue Act in 1913. No less interesting is that, according to the article, the IRS refrains from asking about race or ethnicity even in rare situations when an assessment of tax liability is contingent on it. As one tax expert has noted, being colorblind may have served a protective purpose in the early days of the income tax when being identified as a minority entailed considerable risk for overt racial discrimination by government. Today, it is a major impediment to obtaining an understanding of any disparate effects.

Racial equity matters aside, this absence of information creates a basic taxpayer transparency and accountability issue, especially with respect to tax expenditures and their mammoth role they play in the federal budget. The Biden administration has issued an executive order establishing an Equitable Data Working Group which includes the Treasury Assistant Secretary for Tax Policy suggesting some changes may be forthcoming in the next few years.

Until any such information is available, scholars and researchers have two approaches to examine racial inequity in the tax code — both of which are sub-optimal. The first is to generate their own descriptive statistics by imputing tax impacts from non-tax data. This is done by cobbling together information and data available from other agencies and employing complicated research designs to control for income and other variables that can affect results besides race. A few of the more notable federal tax policy topics on which such studies have been done (and found evidence of disparate racial impacts) include:

- marriage penalties and bonuses in the individual income tax
- federal earned income tax credit
- tax preferences for pension contributions and earnings
- reduced tax rate on capital gains
- carryover basis on capital gains and gifts

Policy think tanks are attempting to provide additional assistance to these types of investigations. For example, the Urban-Brookings Tax Policy Center is now embarking on an effort to update its microsimulation tax model to better inform these issues. Yet the relative scarcity of such studies over the decades indicates how challenging these investigations can be. Moreover, social science research designs and their conclusions are always justifiably open to critique and criticism and therefore are a poor substitute for publicly funded and available tax data directly from government institutions.

The second is to study the existence of income and wealth inequality fostered by the tax code and use it as a proxy for racial bias. The analytical justification is that tax provisions which disadvantage lower income households have a disproportionate impact on racial minorities because they, in turn, are disproportionately represented among

[2] "Should the IRS Know Your Race? The Challenge of Colorblind Tax Data, Jeremy Bearer-Friend, Tax Law Review, Volume 73 Fall 2019

people at the lower end of the economic scale. It's an idea prevalent in many of the special reports and commentary pieces we have reviewed.

However, it can be argued these studies are actually capturing bias and inequities against economic class due to decades of having the economic interests of higher and middle-income taxpayers prioritized in tax policy because of their greater representation in government, not racial discrimination. To many, this appears to be a distinction without a difference. In any event, it provides an explanation why the recommendations contained in recent reports and commentaries examining racial bias — adoption of more progressive income taxation, higher corporate taxes to fund state services, expansions of working family credits, etc. — are largely indistinguishable from previous work and advocacy by progressive interests over the years to reduce income inequality and improve tax fairness.

Linking assessment growth to zip-code-level indexes would reduce racial inequality by 55–70% with further reductions available.

A Closer Look at Racial Equity in Property Taxation

Income taxation is only one piece of the tax system. Perhaps the most direct and striking evidence of structural bias and disparity comes from two recent research studies examining local property taxation.

The first, a report from the Federal Reserve Bank of Minneapolis[3] merged data from 118 million homes in the United States with geolocation detail for 75,000 taxing entities. It documented a nationwide "assessment gap" — overassessment of less expensive homes and underassessment of more expensive homes — which leads local governments to place a disproportionate fiscal burden on racial and ethnic minorities.

The study found, controlling for jurisdictions and property tax rates, black and Hispanic residents face an average 10–13% higher tax burden for the same bundle of public services. The assessment gap is attributable to two factors. First, residential racial sorting creates different neighborhood characteristics which are captured by market prices but not as readily by assessments which focus on home attributes. Second, assessment appeal behavior and outcomes differ by race. Using administrative court records researchers found minority homeowners were less likely to appeal their assessment, less likely to win their appeals, and even if the appeal was successful would receive a smaller reduction than non-minority residents.

Can these disparities be fixed? Commenting on the assessment gap problem, Fed researchers concluded market prices "can be so sensitive to geographic variation and property prices so temporally unpredictable, even the most skilled and attentive assessor's office would not be able to equalize tax burdens by racial status." As a proposed solution, researchers recommended generating assessments that incorporate small-geography home price indexes. They estimated simply linking assessment growth to zip-code-level indexes would reduce racial inequality by 55–70% with further reductions available using house price indexes that are more carefully calibrated to local geographies.

Another study, from the University of Chicago Center for Municipal Finance also focused on the racial disparities in property assessments and its implications.[4] Based on a national analysis of assessment ratios and tax rates relative to sale prices for a sample of 26 million residential sales, the researchers found that assessments are typically regressive, with low-priced properties being assessed at a higher value, relative to their actual sale price, than high-priced properties. Within a jurisdiction, homes in the bottom decile of sale price face an assessment level, as a proportion of sales price, that is twice as high as that faced by homes in the top decile, on average. This regressivity was found to be evident throughout the U.S. and again is linked to limitations in the data and methods used by assessors. In short both found widespread racial inequalities in the distribution of U.S. property tax burden.

How does Minnesota's property tax assessment and administration grade out in these investigations? The Federal Reserve paper offers little granularity on Minnesota's performance at either the state, county or jurisdictional level. Eyeballing a bar chart of state level estimates of the assessment gap, it appears Minnesota slightly outperforms the average — around an 8%-9% assessment gap for black residents. The University of Chicago Center for Municipal Finance offers more detail on its findings through a web-based tool providing a look at assessment to sales price ratio at the state, county, city and census tract levels with ad-

Table 2: Property Tax Equity Measures for Hennepin and Ramsey Counties

	Hennepin County	Ramsey County
Top decile sales ratio (most expensive homes)	85.7%	86.0%
Bottom decile sales ratio (least expensive homes)	77.1%	80.3%
Top decile effective tax rate	1.29%	1.39%
Bottom decile effective tax rate	1.51%	1.78%
Price Related Differential (PRD)	0.984	0.98
State Rank (out of 87)	33rd least regressive	18th most regressive

Sales ratio: Assessment / Sales Price
Effective Tax Rate: Property Tax / Sales Price
Price Related Differential: Measure of regressivity or vertical equity. A PRD of 1.0 indicates homes are assessed at the same rate regardless of their sale price. A PRD greater than 1 means less expensive homes are assessed at higher rates than expensive homes. Conversely a PRD, less than 1 means more expensive homes are assessed at rates higher than less expensive homes.
Source: University of Chicago Center for Municipal Finance property tax webtool *https://propertytaxproject.uchicago.edu/data/*

3 "The Assessment Gap: Racial Inequalities in Property Taxation," Avenancio-Leon and Howard, Federal Reserve Bank of Minneapolis, Opportunity & Inclusive Growth Institute, Working Paper 34, July 2020

4 "Reassessing the Property Tax" Christopher Berry, The University of Chicago Center for Municipal Finance, Harris School of Public Policy, Working paper draft February, 2021

ditional school district information. Table 2 (page 4) presents some key property tax equity measures (for 2016, the most recent year available) for Hennepin and Ramsey counties which have the two largest black population shares.

In both counties both the most expensive and least expensive homes were considerably under assessed relative to their sales prices — likely reflecting annual assessments unable to keep up with a "hot" Twin Cities real estate market affecting all home values. Although the least expensive homes were under assessed by a greater amount, effective tax rates were higher as home value differentials offset assessment differentials. As indicated by PRD values less than 1.0, expensive homes in both counties were assessed at higher rates than less expensive homes. Both counties are substantially below the U.S. county median on the PRD measure.

This comparison of home selling prices with their assessed value at the time of sale suggests Minnesota property tax assessment and administration offers far greater property tax equity and fairness than most states. However, it's important to recognize county level aggregate summaries can mask disparate racial effects at much smaller geographical levels. By clicking on a county report on the website tool one can drill down to the colorized census tract level which includes nonwhite population share information. This allows users to see how "neighborhood" level sales ratios may differ by racial composition. (Such an analysis was far beyond the scope of this article.)

Where Do We Go From Here?

We don't expect another exchange similar to what occurred in the tax committee several weeks ago, but we do believe racial equity is now established as part of state tax policy debate and will continue to be an influential undercurrent and force in how we think and talk about taxation. The question is how will it manifest itself.

One possibility is reflected in two recent articles published by State Tax Notes under Tax Analysts' new feature, "The Search for Tax Justice." In one contribution entitled, "U.S Tax Systems Need Anti-Racist Restructuring" three law scholars ascribe a legacy of racist motivation and intent with regards to our tax system. The authors group the U.S. tax system with slavery, Jim Crow laws and lynching as "constituting and perpetuating white advantage and black disadvantage." They argue any anti-tax sentiment is "a manifestation of pervasive and continuous racism" and "tax systems are both a symptom of and instrument of systemic racism." Another contribution entitled "More for Less: How Property Taxes Fuel Racial Inequality" argues the administration of the local property tax as we know it is essentially irredeemable saying it "stands at the heart of a vicious cycle that perpetuates racial inequities in housing markets and schools." The scholar's proposed fix is to take property tax collection and distribution out of the hands of local governments (and presumably give it to the state) which we can confidently declare would be an unmitigated disaster for local control, transparency, and revenue predictability.

The other is using time-tested sound tax policy principles like transparency, simplicity, neutrality and fairness to guide our thinking to advance this objective in the pursuit of better state and local tax systems. For example, the House omnibus tax bill includes the creation of a new tax expenditure review commission to study the impacts and policy merits of the ever-growing number of incentives and subsidies running through our tax code. Tax expenditures are an especially ripe area of investigation since racial minorities may be disproportionately unable to access these tax favored choices/actions due to lower levels of income or wealth. For tax expenditures which are determined to support an important public policy purpose, there may be modifications to consider like replacing deductions, exemptions and exclusions with proportional credits to provide equal benefit for all income levels from the same tax-favored activity.

Although it remains to be seen how the discussion and debate will unfold in this state, we have a pretty good sense of which approach is likely to be more productive. ■

From The Director:
Minnesota's Proposed Taxation of Foreign Earnings: What We Know

Confession: I have given up trying to understand the complexities of how taxing foreign profits now works. Territorial vs. worldwide vs. destination-based corporate tax systems and hybrids thereof; participation exemptions; all the definitions and rules surrounding controlled foreign corporations, unitary groups, transfer pricing, and foreign tax credits; Qualified Business Asset Investment; Subpart F income; the acronym stew of new categories of income and taxes and how they work (e.g. GILTI, FDII, and BEAT, a.k.a. Global Intangible Low Taxed Income, Foreign Derived Intangible Income, and Base Erosion and Anti-Abuse Tax respectively) – the list goes on and on. The goal of the TCJA with respect to corporate taxation was to address and balance two important policy matters simultaneously: create a system that is globally competitive while at the same time tackle the very real and legitimate problem of corporate profit-shifting and tax base erosion. MCFE members steeped in this world have patiently answered my questions but every response seemed to send me scrambling to another section of the Internal Revenue Code for another definition or to try to gain familiarity with another issue.

Mark Haveman

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As a result, I admit to some bemusement juxtaposing my experience grappling with this topic with how a provision in the House omnibus tax bill (HF 991) to tax foreign earnings was talked about in recent legislative hearings. The testimony made it all sound so easy. Pass a law and, voilà, hundreds of millions of dollars in recurring revenue from big tax scheming corporations are available to fund education, health care, and a lot of other essential state services. It reminded me a little bit of that old South Park cartoon scene-turned-viral-meme in which tiny humanoids called the Underpants Gnomes present a business plan:

Phase 1: Get underpants

Phase 2: ?

Phase 3: Profit!

This provision is pretty much guaranteed to not make it out of conference committee (and for that matter is not even in the Governor's tax proposal). But interest in having the state get its share of foreign income on top of the federal government's efforts is not going away.

In spite of our white flag now waving in the breeze, there are a few things we now do know about state efforts to go after foreign profits:

We know what we are looking to capture is fundamentally flawed and in need of reform.

GILTI - a focus of the House bill — was created by Congress at warp speed under purely political time constraints, and the resulting problems have now become evident. Martin Sullivan, former U.S. Treasury staff economist, chief economist and contributing editor of *Tax Analysts*, and a long-time investigator and critic of multinational tax avoidance has this to say about GILTI as a solution:

> *In general, a minimum tax on foreign profits is an excellent disincentive to profits shifting. Unfortunately, the all-important details of the GILTI provisions, which are overlaid in existing complex rules, are mind-numbingly complex and arbitrary. And the economics stink too. In some cases, GILTI provides negative marginal tax rates on foreign investment. In other cases, it provides marginal tax rates well in excess of the US or foreign statutory rate. Major reforms and simplifications of GILTI must be undertaken by Congress passing new law. Treasury cannot fix the major problems by regulation.*[5]

This is on top of the more fundamental issue of whether Minnesota can tax income earned entirely outside this state, let alone this country, by an entity that itself has absolutely no connection ("nexus") to Minnesota. Moreover, according to recent statements by Treasury Secretary Janet Yellen, the U.S. will adopt a more cooperative approach to working with the Organization for Economic Cooperation and Development (OECD) in its ongoing initiative to develop and implement a global minimum tax. Depending on the progress of this initiative, the GILTI provisions would undergo substantial change if not repealed altogether.

We know corporate income taxation by subnational governments is quite rare in the world.

Of the 48 other countries comprising the OECD — representing nearly 90% of global GDP — only eight have some form of subnational corporate income tax. Only five include in their subnational tax bases passive income earned by foreign subsidiaries under the controlled foreign corporation (CFC) rules established under national law. Only one (South Korea) subjects active foreign source income to full subnational taxation (at a maximum rate of 2.5%).[6] It's a major reason why worldwide combined reporting was considered and rejected by the OCED in their efforts to address profit shifting and base erosion. Most countries look unfavorably at subnational tax actions as resulting in unequal, adverse treatment of their own domiciled companies.

We know that insufficient attention has been given, and understanding generated, on the additional administrative burdens and costs the state, and taxpayers, would incur.

To our knowledge, no public testimony was given by the Department of Revenue on the additional staffing and resources needed to handle compliance activities, auditing activities, enforcement activities, taxpayer appeals, legal support, return processing, outreach efforts, internal education and training initiatives, and other administrative matters to support a foray into GILTI taxation and worldwide combined reporting. No fiscal note was prepared by the Legislative Budget Office on these matters. A couple of years ago, what would appear to be a comparatively more modest bill which included a provision for a new private letter ruling program (which a majority of states have), making some changes to auditing domestic sales and use tax returns, and allowing refunds for up to two years after a tax was paid carried a $69 million biennial price tag and the addition of 130 full time equivalent employees for the Department.

A typical large multinational with sales and operations around the world ordinarily has one-hundred or more controlled foreign entities around the globe — the income and loss of which would need to be reported on the Minnesota state return. In the case of worldwide combined reporting, the current Minnesota tax form requires line by line aggregation of data and information for each foreign as well as domestic entity, as opposed to consolidated reporting used for financial reporting purposes. That alone would seem to raise some question about staffing necessary to verify this information if it comes up in an audit. We have no idea if a foray into international commerce is a big deal, little deal, or something in between, but we should have an understanding of what's needed to do this, and do this accurately and responsibly, without creating unintended consequences for state tax administration.

We know nobody really has a good idea how much revenue this would bring in.

This is not disparaging the work of the DOR's revenue analysis group or estimates generated by various organizations. It's just that asymmetrical information about firm activities and decision-making in dozens or hundreds of subsidiaries across the globe makes generating reliable forecasts on this matter extremely difficult. To illustrate, the Congressional Budget Office estimated that post-TCJA $235 billion in profits will continue to be shifted offshore annually. That number simply represents a midpoint between two very different academic projections: one of $300 billion; the other less than half that total. Research has shown firms do not provide sufficient information for even close observers and sophisticated users like financial analysts to interpret and predict the future tax implications of foreign operating activities, and that forecasting difficulty is greater for multinational firms regardless of whether foreign operations are inside or outside of tax haven countries.[7] And no dataset exists that allocates corporate profits by state.

We know building hundreds of millions of dollars of permanent government spending on this highly uncertain and volatile foundation doesn't exactly ring the bell of fiscal responsibility.

Even staunch advocates like the progressive Center on Budget and Policy Priorities of Washington, DC has expressed caution on this topic noting, "States conforming to TCJA international provisions can reasonably anticipate legal challenges taking years to resolve. Accordingly, states should not build revenue from conformity into budgets." [8] If Minnesota ultimately chooses to tax foreign earnings it would be wise to use it for one-time spending. The state has a laundry list of such possibilities supporting the benefit principle of taxing businesses – highway projects, local sewer and water grants, and communications infrastructure to name a few.

And, as we have suggested before, "closing the circle" by giving it to the State Board of Investment to reinvest and augment state pension support should be added to that list. There is considerable irony in having state government decrying corporations for dodging their responsibilities while sitting on $16 billion in unfunded pension liabilities using practices that aren't found anywhere else in public or private finance. This messaging would have a lot more moral authority if government wasn't embracing its own legal but dubious accounting practices in order to avoid addressing its own economic obligations.

— M. H.

5 "A reform, wrapped in a mystery, inside an enigma" Martin Sullivan comments to American Enterprise Institute Blog, September 30, 2019

6 *Survey of Subnational Corporate Income Taxes in Major World Economies: Treatment of Foreign Source Income*, State Tax Research Institute, Prepared by Price Waterhouse Coopers, November 2019

7 *Do Analysts Fully Understand the Tax Implications of Foreign Operations?* Erin Jordan, Arizona State University, 2018

8 Michael Mazerov, CBPP, in presentation to the National Council of State Legislators Task Force on State and Local Taxation, March 23, 2018.

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