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In This Issue:

2017 Session Preview

A look at the economic and political landscape shaping the forthcoming budget session

Legislative sessions are shaped by two forces – resources and power – which is why November is always a noteworthy month. The recently-released November economic forecast foreshadowed what may be available with respect to crafting the budget while the November elections determined who has the clout in the crafting. Put them together and they offer a glimpse at what we might expect in the new year – as the hunt for the elusive signed tax bill potentially enters year three.

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The Surplus: Opportunities Galore or a Test of Fiscal Restraint?

State officials appeared rather satisfied during their presentation of the state's November economic forecast for good reason – a respectably performing economy, intragovernmental borrowing completely paid off, a sizeable surplus, and a healthy budget reserve has that kind of an effect. The forecast estimates a $1.4 billion surplus for the upcoming biennium, which excludes the additional $334 million dedicated to the budget reserve bringing it within a whisker of the target (now $2.052 billion) that MMB sets based on economic factors, including revenue volatility.

However, some rather unusual circumstances surround this surplus forecast, largely concerning the 2016 tax bill that was torpedoed by the infamous "conjunction of doom." If that bill had been enacted, tax cuts would have reduced projected FY 2018-19 revenues by $375 million (including property tax relief for business property owners and farm owners) and an additional $169 million would have been spent on aids and credits (including additional money for Local Government Aid and an enhanced Working Family Credit). Those changes would have left lawmakers with about $850 million to work with next year as they craft the FY 18-19 budget.

As of this writing, odds seem to favor teeing up a special session before Christmas to deal with the health insurance premium crisis, although Lucy has pulled that football away from Charlie Brown in the past. The cost of premium subsidies has been ballparked in excess of $300 million, which, if enacted and paid for from the general fund, would put a dent in next biennium ambitions. But it is also possible the tax bill would be resurrected as part of any special session agenda. The price tag of that bill this time around could be higher depending on where effective dates for the various provisions end up being set. The fate of the $266 million general fund appropriation for transportation, which was part of the last minute package of the 2016 session, is also in question. Depending on what parameters and details a special session agreement includes, the money available for additional FY 18-19 spending could be cut by over half.

Then there are the "off the books" biennial expenses that the forecast estimate does not formally recognize. The item that gets all the attention is projected spending inflation, which is included in the forecast estimate for informational purposes. As always, the state's Council of Economic Advisors' statement on the forecast is highly critical of this practice, arguing the projected cost of services as provided by current law for FY 18-19 is understated by roughly $1.7 billion. The other expense – which is completely ignored – is the cost of unmet public pension contribution requirements, which a recent study by the Boston College Center for Retirement Research has estimated conservatively at $590 million annually for the state. Why the Council of Economic Advisors' mini-lecture on fiscal responsibility always harps on this highly debatable and grossly overstated projection of cost inflation while completely ignoring the really dangerous chicanery and budgetary self-deception occurring in public pensions is truly one of the great mysteries of state finance.

Looking at the big picture (see Table 1), FY 18-19 spending is expected to grow by just over $3 billion (7.4%) relative to FY 16-17. Many of the biennial reductions across spending areas likely reflect the one time nature of the supplemental spending bill passed in 2016. Of particular interest is the continuing ability of health and human services to suck up most of the new fiscal oxygen in the budget room. Many have touted the $173 million decline this forecast projects for the health and human service area relative to previous estimates for FY 18-19. The reduction includes $146 million of savings in the area of long-term care. While reforms in this area are yielding important and positive results, health and human service general fund spending is expected to grow 14.4% over the next biennium, or $1.64 billion[1]. In short, health and human services,

[1] Table 1 shows a larger HHS increase. However, according to the economic forecast, only $1.638 billion of this amount is attributable to actual program growth. After adjusting for payment splits and funding delays, the projected underlying biennial growth in HHS is 14.4% for FY 2018-19.

Table 1: FY 2016-17 and FY 2018-19 General Fund Budgets, November Forecast ($000)

Budget Area	FY 16-17	FY 18-19	Change	
			Amount	Percent
Balance Forward	2,103,017	2,982,412	879,395	41.8%
Tax Revenues	40,388,179	43,538,901	3,150,722	7.8%
Non-Tax Revenues	1,501,693	1,418,671	(83,022)	(5.5%)
Other Resources*	491,975	363,248	(128,727)	(26.2%)
Subtotal – Current Resources	**$42,381,841**	**$45,320,820**	**$2,938,979**	**6.9%**
Total Resources Available	**$44,484,863**	**$48,303,232**	**$3,818,369**	**8.6%**
E-12 Education	17,403,462	18,176,964	773,502	4.4%
Higher Education	3,081,146	3,069,493	(11,653)	(0.4%)
Property Tax Aids and Credits	3,348,067	3,466,927	118,860	3.6%
Health and Human Services	11,808,443	14,251,454	2,443,011	20.7%
Public Safety & Judiciary	2,170,205	2,174,294	4,089	0.2%
Transportation	280,022	243,592	(36,430)	(13.0%)
Environment & Agriculture	474,699	403,903	(70,796)	(14.9%)
Jobs, Econ Dev, Housing, & Commerce	514,505	391,680	(122,825)	(23.9%)
State Government & Veterans	1,038,761	1,027,878	(10,883)	(1.0%)
Debt Service	1,138,500	1,142,616	4,116	0.4%
Capital Projects & Grants	266,405	255,985	(10,420)	(3.9%)
Estimated Cancellations	(15,000)	(20,000)	(5,000)	NA
Total Expenditures & Transfers	**$41,502,951**	**$44,584,786**	**$3,081,835**	**7.4%**
Cash Flow Account	350,000	350,000	—	—
Budget Reserve	1,930,388	1,930,388	—	—
Stadium Reserve	24,174	37,690	13,516	55.9%
Budgetary Balance	**$677,850**	**$1,400,368**	**$722,518**	**106.6%**

* Includes dedicated revenues, transfers in, and prior year adjustments.
Note: Dollars in thousands, parentheses signify reductions.
Source: November 2016 Economic Forecast: Minnesota Management and Budget; calculations by MCFE.

which currently constitutes 28.5% of general fund spending, is projected to consume almost 60% of all new general fund revenues in the next biennium. Regardless of what size of biennial surplus actually materializes next year, that trend is alarming.

The forecast has ratcheted back revenue growth expectations a bit since the end of the 2016 session. On a biennium over biennium basis, revenues are now forecasted to grow 6.9% or just over $2.9 billion. Notably, individual income tax receipts account for nearly 80% ($2.3 billion) of that growth. The good news is that the economic forecasters foresee respectable growth in both wage/salary income and non-wage income in the range of 4.7% to 5.1% in both FY18 and FY19. The concern is dependency and accompanying volatility.

The "unbalanced stool" metaphor played a major role in the tax policy changes made in 2013 – the idea being that collections of income, sales and property taxes should be roughly equal when considering all levels of government in Minnesota. At that time property taxes were considered to have too long of a leg. Fast forward to the end of 2016, and the income tax leg is now far longer than the property tax leg was when "balance" was identified as a problem that needed to be fixed. Moreover, we have seen how estimates can deviate from forecast – especially with income sources associated with the highest earners on whom we are now more reliant. For example, in this year's February forecast, MMB anticipated capital gains realizations would grow by 2.0% in 2016. That has since been revised to a *decline* of 5.7%. The $2 billion budget reserve target reflects the now-greater volatility of our revenue system. As excessively large as it may seem to be, it's the price we pay for our revenue system's new realities.

Much can change between now and the definitive February forecast, especially with huge question marks punctuating every area of federal tax and fiscal policy. State officials and legislators appear very cognizant of this uncertainty and the potential implications for the state budget. The disposition of the ACA, economic repercussions of aggressive trade policies, and federal corporate income tax reform in conjunction with a repatriation of foreign earnings (which could be a large windfall for the state) are just a few of the more notable national developments state officials and legislators will have to keep a close eye on.

Divided Government. Again.

The 2017 legislative session will be framed also by November's election results. The conventional wisdom in the months leading up to the election suggested that DFLers had a good chance to reclaim all three lawmaking levers (the House, Senate, and governor's mansion). Instead, Minnesota's voters continued to express a preference for divided government. The House GOP added three members to their caucus; and with 76 seats (and the potential for another at a February special election), the caucus has passed 75 members for only the second time since party designations were put back on election ballots in the early 1970s. DFLers were unable to make gains in rural seats and unexpectedly lost a handful of seats in the metro area.

The major surprise was in the state Senate, where the GOP now holds a 34-33 advantage as the Republican wave that deluged rural House DFLers in 2014 came back for many of their Senate colleagues. Republicans picked up seven seats outside the seven-county metro – primarily in northwestern Minnesota and south of the Twin Cities – while losing only one. A substantial number of senior DFL senators will no longer be around in 2017 – either through retirement or defeat – including the chairs of the Taxes and Capital Investment Committees and the assistant majority leader.

On the flip side, the GOP Senate caucus will be far more experienced in 2017-2018 than they were in 2011-12, even with the loss of their leader. Only one member of that earlier majority – Sen. Doug Magnus – had ever chaired a legislative committee, and that was as a House member. Given that none of those senators had ever even in been in the majority unless they had served as House members, there was a fairly steep learning curve for the caucus. We might expect this relatively more experienced group to have an easier time with the transition of power.

The election results obviously change the dynamics between the three institutions charged with lawmaking – the House, Senate, and Governor Dayton. But clearly the dynamics change the most in the Senate, as the House returns the same leadership with roughly the same political makeup. The last four years in the Senate often saw a struggle within the DFL caucus to find compromises between rural, more conservative members and the more liberal wing – primarily from the metro area. Perhaps the best example came during the 2015 special session, when the final agriculture and environment bill was nearly derailed in the Senate. Looking ahead to the next four years, the operative word will be "consensus". With a 34-member caucus and 34 votes needed to pass any bill, every GOP senator effectively has a veto on legislation that DFLers decline to support – with implications for the caucus' ability to pass controversial measures.

The dynamics between these institutions is likely to be somewhat different than the 2011-2012 session. In large part, that's because the financial situation is far different – the state is dealing with a $1.4 billion surplus instead of a $6 billion deficit. But another difference will relate to the makeup of the incoming crop of legislators. The 2010 election produced a considerable number of Tea Party-affiliated legislators who had an interest in being confrontational. By all accounts, this group of legislators is much more heavily weighted toward small business owners and leading citizens with strong histories of civic engagement. Words like "practical," "thoughtful," and "grounded" have been used to describe many of them to us. Between this and the very small GOP edge in the Senate, it may be easier for the dealmakers to close the agreements than it was in 2011 and 2012.

What to Look For in 2017

Our staff crystal ball acts more like a Magic 8 ball but we'll still offer some predictions about how these election and forecast results will shape the upcoming legislative session. For starters, the election results would seem to foreshadow continuing challenges for the "One Minnesota" ideal, as the parties have now largely coalesced geographically on urban/rural lines. It's nearly impossible now to find a DFLer whose district is either outside the seven-county metro or the Iron Range if it doesn't have a city of at least 25,000. It wouldn't be surprising at all to see the majority caucuses prioritize legislation that focuses on rural economic development, rural transportation infrastructure, and elder issues as outstate Minnesota is considerably older than the Twin Cities. Center cities will have a bulls-eye on their back, and will likely have to rely on Governor Dayton to defend their interests.

Health and human services, which currently constitutes 28.5% of general fund spending, is projected to consume almost 60% of all new general fund revenues in the next biennium.

On the tax front, whether a special session happens or not may be largely inconsequential. The tax bill left on the table in 2016 will be the bill likely to be passed, whether in special session or during 2017. It already has that rarest and desirable of features – bipartisan support – and the money to do any significant expansion on either the relief side or the tax expenditure side really isn't there. Any add-on provisions will likely be heavy on no-cost or low-cost policy/administrative dimensions. If the committees do have some money to work with, one potential tax relief area is in the estate tax, as both tax chairs (Greg Davids in the House and Roger Chamberlain in the Senate) have previously expressed interest in conforming to federal provisions.

But the real question is – will the legislative stakeholders be able to work together productively? One canary in the coal mine will be the budget proposal that Governor Dayton must release by January 15th. Will it be filled with tax provisions and spending increases at a level that renders the budget dead on arrival – and antagonizes the majority caucuses in the process? Or will there be provisions building on the past and subsequent efforts on both sides to help close the remaining differences that left us tantalizing close last May? If it's the former, watching the 2017 session may turn out to be like watching a bad action movie – all the car chases and gun fights may be entertaining, but 10 minutes in you know exactly how it's going to end. ■

Practitioners Corner: Taxpayers Dancing in the Dark

Guest contributors Chris Martin and Emily Miller of Grant Thornton[2] argue that Minnesota should join the majority of other states in implementing a private letter ruling program to improve transparency and guidance in the application of Minnesota tax law.

Chris Martin

Emily Miller, J.D.

Anyone who has spent time reading Minnesota's tax statutes soon finds themselves directed from one citation to another. Throughout the law, there are cross-references, undefined terms, and references to the Internal Revenue Code. Even then, the guidance found may be uncertain at best. In a time when the Minnesota Department of Revenue ("Department") is issuing fewer revenue notices and promulgating no rules, guidance to effectively dance through the state's tax code is crucial to an efficient use of a taxpayer's and the state's limited resources.

One light that would help illuminate the darkness is a private letter ruling ("PLR") program. Minnesota is one of the few states without a PLR program, which would provide guidance to taxpayers, tax and non-tax attorneys, non-Minnesota tax practitioners, and pro se individuals who are otherwise dancing in the dark, doing their best to predict how the Department may interpret and apply uncertain tax positions.

2 Chris Martin is a Senior Manager and Emily Miller is an Associate in the State and Local Tax (SALT) practice with Grant Thornton's Minneapolis office.

The PLR: Shining a Light into Murky Areas of Tax Compliance

Good public policy requires state tax laws and rules to provide transparency, accessibility, fairness, efficiency, and certainty for taxpayers and tax practitioners. There are a variety of initiatives that the Legislature and the Department could implement to improve these objectives. One initiative that would provide more transparency is a robust "taxpayer bill of rights." Over the years, the issues taxpayers face have evolved but the policies and procedures in which a taxpayer may address those matters have stagnated, resulting in an ever darkening space between taxpayers and the Department.

The Department's mission statement is "[w]orking together to fund Minnesota's future" and its vision is that "[e]veryone reports, pays, and receives the right amount: no more, no less." These statements have the potential to impart good public policy; however, in practice the Department has hindered transparency and certainty through a dramatic decrease in the issuance of substantive guidance and revenue notices within the past ten years.[3] The Department's latest Rule was published in July 2011.

These principles of good public policy are important and have been at the forefront of legislators' minds. In March 2016, the Minnesota House Taxes Committee heard testimony on H.F. 2876, which, among other provisions, would require the Department to provide a PLR program.[4]

An effective PLR program can promote principles that bring about good tax policy: transparency, accessibility, fairness, efficiency, and certainty.

A PLR is a written communication from the Internal Revenue Service, a state's department of revenue, commissioner, or other state official on how the issuing party's tax law would be applied in response to a specific taxpayer's inquiry.[5] The request for a PLR must be specific to a factual situation. Generally, hypotheticals or alternative transaction scenarios are not permissible requests. To request a PLR, the taxpayer must include all the material facts including, but not limited to, all interested parties, the business reason for the transaction, and any additional pertinent information related to the underlying issue. Some states charge a few hundred dollars for a PLR and as much as $10,000 for an expedited PLR,[6] however most states issue PLRs without charge.

As many as 38 states have some type of PLR program.[7] Depending on the state, letter rulings may be revoked after a specified period of time, typically five or ten years. When an issuing department responds to inquiries with similar fact situations, the department should maintain consistent treatment and application of the tax law, prior revenue notices, PLRs, and case law to ensure fairness.

The advice and interpretation from the issuing department is binding on the issuing department only as it applies to the taxpayer who submitted the inquiry requesting the ruling. Once the PLR has been sent to the taxpayer, the department may publish the redacted PLR as guidance for similarly situated taxpayers.[8] Generally, any information or fact that would identify the taxpayer (i.e., taxpayer name, taxpayer address, any confidential return information, or specific trade secret information) would be redacted in the published version.[9] Published PLRs, even in their redacted form, provide meaningful guidance to other taxpayers because they include insight as to how the issuing department interprets and applies the law on uncertain tax positions. If the taxpayer requesting the PLR is facing an uncertain tax position, there are likely other taxpayers dealing with a similar, if not the same, question.

An effective PLR program can promote principles that bring about good tax policy: transparency, accessibility, fairness, efficiency, and certainty. Published PLRs would reveal the Department's position on issues in a transparent way and would be accessible to all taxpayers. A PLR program in Minnesota would ensure more consistent and fairer application of the Minnesota tax code to similarly situated taxpayers as the public would have access to previously issued PLRs. An analysis of the Department's interpretation of the tax law provides visibility into the Department's policies, which may help taxpayers avoid the audit process, administrative appeals, and/or filing in Tax Court. This results in more efficient use of taxpayer and government resources. The program could also provide certainty because taxpayers are able to predict how the Department would apply the state tax code to a particular fact pattern. Depending on the specific inquiry, PLRs have the potential to provide guidance, albeit not binding, to an extensive demographic of taxpayers.

PLR Programs in Other States

More and more legislatures are embracing transparency with taxpayers:

- In the 2016 legislative session, Maryland passed a bill requiring the Maryland Comptroller's Office to establish a PLR program.[10]
- In North Carolina, the Secretary of the Department of Revenue historically had authority to issue advice to taxpayers that requested guidance; however, the

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3 On the continuum of authority, revenue rulings are one of the most authoritative publications. In the order of most authoritative to least authoritative, adopted rules or regulations are the most, followed by revenue notices/revenue rulings, then PLRs, next general informational letters, and finally factsheets, FAQs, and form instructions. Rules: http://www.revenue.state.mn.us/law_policy/Pages/Rules.aspx; Revenue Notices: http://www.revenue.state.mn.us/law_policy/Pages/Revenue-Notices.aspx

4 H.F. 2876. The full bill history is available at https://www.revisor.mn.gov/bills/bill.php?f=HF2876&b=house&y=2015&ssn=0; video testimony on H.F. 2876 is available at http://www.house.leg.state.mn.us/htv/programa.asp?ls_year=89&event_id=888303. A fiscal note for H.F. 2876 was requested but never completed.

5 Some states issue written communications that are similar to PLRs, however they are titled differently: Florida issues Technical Assistance Advisements; Maine issues Advisory Rulings; New York issues Advisory Opinions; California issues Chief Counsel Rulings; and New Hampshire and Rhode Island issue Declaratory Rulings.

6 See Tenn. Code Ann. § 67-1-109(f).

7 It is difficult to determine exactly how many states have a PLR program because not all states publish PLRs or provide readily available PLRs without formally requesting copies

8 Most states that have a PLR program or the equivalent do publish rulings in some manner. For example, Illinois has research databases dedicated to PLRs and general information letters. However, Wisconsin's PLRs are only published in the Wisconsin Department of Revenue's quarterly Tax Bulletin.

9 New York does not redact its Advisory Opinions.

10 Maryland General Assembly S.B. 843 (2016).

Secretary was not required to publish the advice provided to the taxpayer. During the 2015-2016 session, the North Carolina legislature passed a law requiring the North Carolina Department of Revenue to publish a redacted version of the advice on the Department's web site thus making the determinations readily available to all taxpayers.[11]

- Illinois has a robust program on issuing PLRs and GILs.[12] The Illinois Department of Revenue issues PLRs and GILs on two tax types, income and sales and use. In the last ten years the Illinois Department of Revenue averaged almost 150 GILs per year and fewer than 12 PLRs per year.[13] (See Chart 1.)

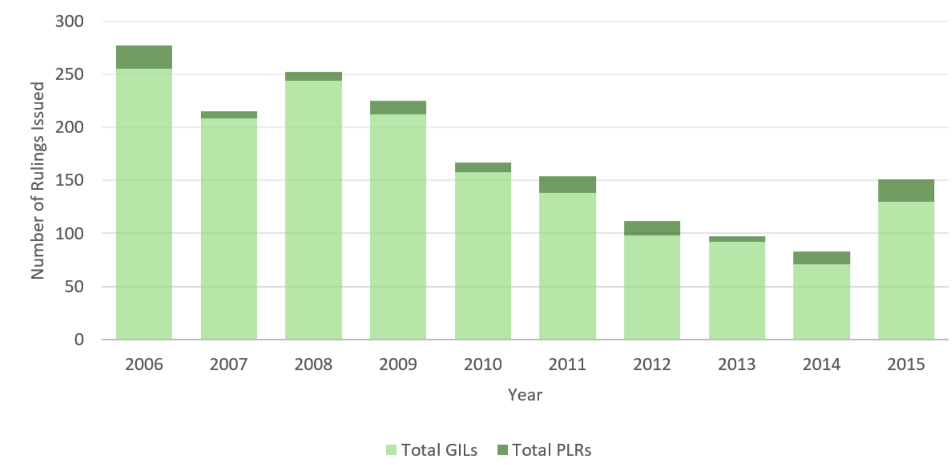
- In Texas, the Texas Comptroller issues letters on its state tax automated research ("STAR") system.[14] The STAR system is similar to a PLR program because it provides a robust online database of responses to taxpayer questions submitted to the Comptroller from the simple to the complicated and nuanced.

- In New York, the State Department of Taxation and Finance is extremely active in publishing advisory opinions (PLR equivalents) covering various tax types. Over the last ten years, New York averaged 16 income/franchise tax, 43 sales tax, and six other tax type advisory opinions per year.[15]

The Minnesota Debate

Currently, the Department is underutilizing its authority to issue revenue notices in order to provide taxpayers guidance on unclear tax positions. As introduced in 2016, H.F. 2876, Section 1 ("proposed program") would direct the Minnesota Commissioner of Revenue to establish a PLR program providing guidance to taxpayers as to the treatment of Minnesota tax law regarding specific transactions or factual situations.[16] As part of the proposed program, the Department would be able to place limits on the scope of the program similar to how the Illinois Department of Revenue only issues PLRs and GILs on income tax and sales and use tax matters. The proposed program even provided that the Department could charge a fee to cover the additional costs associated with providing this service, which most state PLR programs do not include.

Chart 1: Illinois Department of Revenue: Issued PLRs & GILs



During testimony on H.F. 2876, the Department made it quite clear that it opposes a PLR program.[17] The Department argued that a PLR program would take away from its broad-based services and education programs, i.e. plain language fact sheets, industry guides, and free educational online courses. For example, during 2015, the Department's sales and use tax division responded to approximately 60,000 phone calls and 12,000 e-mails. The Department estimated that of those approximately 12,000 e-mails related to sales and use tax questions, over half contained substantive legal inquiries. A PLR program that also included GILs would allow the Department to publish redacted versions of some of those 6,000 e-mails that asked substantive legal questions. It is more than likely that the Department has had to answer the same substantive legal question multiple times. If a PLR program were in place, the Department would have the authority to answer those questions once so that many taxpayers, not just the individual initiating the e-mail request, may reference and use the guidance.

From the Department's viewpoint, PLRs provide a narrow application of the law because they are only binding on one particular, typically sophisticated taxpayer. Moreover, the Department contends PLRs are costly to both the taxpayer and the Department. The Department is correct that PLRs are only binding on the Department vis-à-vis the single taxpayer requesting the PLR, however there is a broader application. However, published PLRs would provide guidance to all taxpayers, tax and non-tax practitioners alike, and Minnesota and out-of-state individuals facing similar situations, not just the sophisticated taxpayers that are able to hire outside counsel or accountants. Published PLRs, even in their redacted form, provide similarly situated taxpayers guidance and insight as to how the Department applies the Minnesota tax code to a particular uncertain transaction.

A PLR program may also help to avert tax litigation. A PLR on how the Department interprets and applies Minnesota Statute § 290.01, subdivision 19b(6) (2014) and IRS Publication 17 would have been beneficial to the taxpayers who were audited to substantiate their charitable contribution deduction but in the end successfully endured a time-consuming and costly litigation process.[18] In another example, a PLR on the application of the definitions of "tangible personal property" v. "real property" as applied to drying systems that Dahmes Stainless,

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[11] N.C. Gen. Stat. § 105-264.2 (2016).

[12] General information letters ("GILs") are non-binding letters that contain a general discussion of tax principles or applications focused on a specific area of interest. In GILs, the issuing department does not interpret or advise on the state's tax laws, rather they provide general information on a scenario. GILs could somewhat be compared to the Fact Sheets the Department publishes.

[13] The Illinois Department of Revenue PLRs are available at: http://www.revenue.state.il.us/legalinformation/

[14] The Texas Comptroller letters are available at: https://star.cpa.texas.gov/

[15] The New York State Department of Taxation and Finance advisory opinions are available at: https://www.tax.ny.gov/pubs_and_bulls/advisory_opinions/ao_tax_types.htm

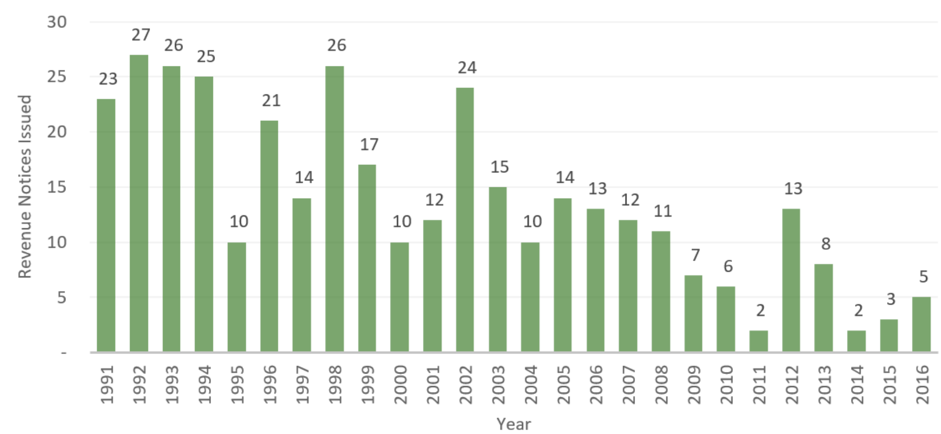
[16] H.F. 2876, supra note 5.

[17] Video testimony on H.F. 2876 is available at http://www.house.leg.state.mn.us/htv/programa.asp?ls_year=89&event_id=888303.

[18] See Antonello v. Commissioner of Revenue, 884 N.W.2d 640 (Minn. 2016).

[19] See Commissioner of Revenue v. Dahmes Stainless, Inc., 884 N.W.2d 648 (Minn. 2016); see also the lower court's decision Dahmes Stainless, Inc. v. Commissioner of Revenue, Dkt. No. 8228-R (Minn. Tax Ct. 2015).

Chart 2: Minnesota Department of Revenue: Issued Revenue Notices



Inc. manufactures and installs could have avoided litigation.[19] In each of these examples, the Department's broad fact sheets, industry guides, and lack of revenue notices potentially underserved the taxpayers, resulting in costly litigation for both taxpayers and the state.

A Diverse Customer Base Demands Different Products

During the testimony on H.F. 2876, the Department volunteered statistics regarding their internal survey of taxpayers who had been through a sales and use tax audit to demonstrate taxpayers' satisfaction. Of the taxpayers that responded to the survey:

- 92 percent felt that they were informed during the audit;
- 89 percent agreed that auditors provided quality education about sales and use tax laws and how to stay in compliance;
- 93 percent felt that the auditors used time in the taxpayer's office wisely; and
- 95 percent felt that the auditors treated taxpayers fairly during the audit.[20]

The Department views the results as proof that it is providing "strong customer service" to Minnesota taxpayers.[21] None of these statistics address the issue of lack of guidance on more complex and nuanced matters and inconsistent treatment of taxpayers.

In contrast, the Minnesota Center for Fiscal Excellence conducted its own (admittedly) unscientific survey ("MCFE survey") to obtain feedback and perspective from tax practitioners regarding the Department's administrative practices.[22] Based on the MCFE survey, the major concerns practitioners addressed were the Department's lack of rulemaking, lack of knowledge base, lack of internal consistency within the Department, and lack of communication beyond citing published fact sheets. The MCFE survey underscores a broader scope of issues than the select items the Department chooses to highlight. Both of these surveys provide very different pictures of how taxpayers perceive the Department. The "typical" taxpayer consensus is likely somewhere in between. Not all taxpayers are being underserved by the Department; however, there are likely more taxpayers being underserved than the Department's survey would seem to acknowledge.

While a PLR program is but one tool available to a department to promote good tax policy and taxpayer compliance, other tools may be effective as well. The Minnesota Legislature gave the Department authority to make available revenue notices over 25 years ago. Unfortunately, there has been a dramatic decrease in the number the Department has issued within the last several years. (See Chart 2.) During the 1990's, the Department had a robust revenue notice program and issued as many as 27 in one year and averaged nearly 20 per year. In the last ten years, however, the Department has not focused on providing clarity to taxpayers on uncertain tax positions, but rather on revoking and or amending previously issued revenue notices. In the last five years, the Department has issued a total of only 16 revenue notices that do not merely revoke altogether or revoke and replace previously issued notices. One reason behind the support for a PLR program is that taxpayers are being under served by the Department through lack of revenue notices.

A complementary initiative to a PLR program would be a robust publication of substantive revenue notices. The Minnesota Legislature gave the Department authority to publish revenue notices over 25 years ago.[23] Unfortunately, there has been a dramatic decrease in the number the Department has issued within the last several years. (See Chart 2.) During the 1990's, the Department had a robust revenue notice program and issued as many as 27 in one year and averaged nearly 20 per year. In the last ten years, however, the Department has not focused on providing clarity to taxpayers on uncertain tax positions, but rather on revoking and or amending previously issued revenue notices. In the last five years, the Department has issued a total of only 16 revenue notices that do more than merely revoke altogether or revoke and replace previously issued notices. Taxpayers, underserved by the Department through lack of substantive revenue notices, would benefit from more visibility to the Department's interpretation of the law through revenue notices and a complementary PLR program that addresses taxpayer fact patterns that may not have been addressed by statute or regulation.

Citing a 1991 study, the Department continues to adhere to its policy that the Department's resources should be allocated to reach the broadest scope of taxpayers.[25] The problem is that tax issues facing taxpayers have shifted over the years as the tax code has changed and grown more complex. Therefore, it is conceivable that the needs of taxpayers have shifted over the years since the Department's latest study on how it should allocate its resources. While the broad-based education, fact sheets, and industry guides are needed, necessary and useful, there is a desire among taxpayers to receive more substance and guidance from the Department. While the Department values "strong customer service", it may be underserving taxpayers that require more

[20] Video testimony, *supra* note 19

[21] Video testimony, *supra* note 19

[22] "Practitioner Perspectives on the State of Minnesota's Tax Administration" MCFE Issue Brief No. 15, December, 2016

[23] Minn. Stat. § 270C.07. The oldest revenue notice available on the Minnesota Department of Revenue's website is from 1991.

[24] The revenue notices are available at http://www.revenue.state.mn.us/law_policy/Pages/Revenue-Notices.aspx

[25] Minnesota Department of Revenue Study, Study on Dissemination of Administrative Determinations, Jan. 7, 1991.

From The Director

Mark Haveman

My thanks to Chris Martin and Emily Miller for their contribution to this edition of Fiscal Focus. A reminder to all our tax practitioner members; we appreciate and welcome the opportunity to publish opinion and commentary pieces like this that present your perspective and arguments on important state tax policy matters. We know it is an investment of time and effort on your part, but those on the front lines can communicate the importance and relevance of these issues in ways we on staff cannot. We hope more of our members will take advantage of this opportunity. Don't be shy!

The timeliness of the month's piece is especially noteworthy given our recent Issue Brief on the state of state tax administration based on our survey of tax practitioners (which can be found under the "Studies" tab on our website www.fiscalexcellence.org). PLRs are a specific strategy within a much broader collection of ideas and issues about advancing consistency, predictability, and transparency in state tax administration and ultimately the degree, cost, and quality of voluntary compliance with tax laws.

We are also very appreciative of the Department of Revenue's engagement on these issues and their past and future efforts to work with the tax community on these matters. Differences of opinion will always exist on ways to address concerns, but ensuring that communication lines are open and input is received and heard is step one. The Department is to be commended for making that happen.

Thank you all for your continuing interest in and support of the organization in 2016. On behalf of Aaron and Linda, let me wish all of you a happy and joyful holiday season and our very best wishes for a healthy and prosperous 2017. — M.H.

guidance than what broad-based education and plain language facts sheets can provide.

The Department is underserving the taxpayers of Minnesota without a PLR program, similar to the ones in place in over three dozen other states. PLR programs provide guidance, certainty and transparency to business taxpayers, non-tax attorneys assisting clients with tax issues, tax practitioners, and pro se individuals that are otherwise dancing in the dark speculating how the Department may interpret and apply the tax code. A PLR program would have a broad application to thousands of taxpayers and does not need to come at the expense of the educational services the Department currently provides. The Department must do both—broad based education and specific guidance.

Minnesota taxpayers and tax practitioners deserve better guidance in order to ensure that those taxpayers who are paying for Minnesota's future are well-equipped to do so. ■

Greatest (Research) Hits of 2016

Some new insights from the National Bureau of Economic Research on the relationship between taxes and business investment, work incentives, and inequality.

With its indecipherable terms of art, incomprehensible mathematics, and turgid prose, the "publish or perish" world of academia often seems to go out of its way to make its research as inaccessible as humanly possible to the real world of policy making. But that doesn't mean scholarly papers don't have important insights to share.

We subscribe to the National Bureau of Economic Research's Working Paper listserve, which offers a look at the latest research coming out on all dimensions of tax and fiscal policy. For every one paper we have occasionally featured in a standalone article in Fiscal Focus, there are probably ten others that have some relevance to key issues being discussed in this state. So as the year closes, we thought we'd highlight a few of the more interesting findings and conclusions we've come across.

On taxes and business investment – Expensing of capital purchases promotes capital investment, at least among smaller firms that can realize immediate cash flow benefits. Analyzing data from over 120,000 firms, researchers found bonus depreciation raises investment in eligible capital relative to ineligible capital by 16.9%.[26] The policy is especially relevant to small firms which respond 95% more than large firms. But firms only respond to these investment incentives when the policy generates immediate cash flow benefits, not when cash flow comes in the future.

For larger, publically traded firms attention to a different policy area may be in order – the research and development credit. An examination of how the public corporation in the United States has evolved over the past forty years[27] unveiled a remarkable and profound shift in business investment activity as these firms now invest far less in physical assets but much more in R&D. In 1980 the average public corporation spent almost 7 times more on capital than on R&D. Today R&D expenditures are 78% higher than capital spending.

On taxes and work incentives – The interactive effects of the design of income support programs, eligibility thresholds, minimum wage laws, and the tax code remains an important public policy issue. A study examining marginal tax rates facing low-income families showed enormous variation across families who participate in different combinations of income support programs.[28] Families participating in two or more programs face negative or modestly positive marginal tax rates at low earnings levels, but usually face very high rates at higher earnings ranges, often up to 80% and occasionally over 100%. While the fraction of families in this category is not large, they constitute about one-fifth of single parent families.

But there is another major and rapidly growing demographic hugely affected by these issues. Another study examined work dis-

26 "Tax Policy and Heterogeneous Investment Behavior" NBER Working Paper No. 21876, January, 2016

27 "Is the American Public Corporation in Trouble?" NBER Working Paper No. 22857, November, 2016

28 "Trends in Cumulative Marginal Tax Rates Facing Low Income Families" NBER Working Paper No. 22782, October, 2016

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incentives facing the elderly, who lose federal and state benefits with higher earnings – with a special emphasis on the clawback of disability benefits resulting from Medicaid and Social Security's complex earnings tests.[29] As they retire, Baby Boomers will face high and in many circumstances extremely high work disincentives. Researchers found the marginal tax rate associated with a significant increase in senior earnings (e.g. $20,000) due to part time work is dramatically higher than that associated with a relatively small amount (e.g. $1,000) of extra income. Working harder and longer to maintain living standards in retirement faces headwinds thanks to the "hodgepodge design of our fiscal system."

On taxes and inequality – The ultimate test of inequality and fairness is defined by living standards which recognize that unequal distribution of income and wealth can be and is offset by progressive spending policies. A study examining this issue concluded the progressivity of our national and state spending systems puts a notable dent in income and wealth inequality as measured by lifetime spending.[30] The study found the distribution of lifetime spending, while still highly unequal, is considerably more equal than either net wealth or current income. The results are reflected in "lifetime marginal tax rate" findings that capture the present value of additional lifetime spending per dollar of additional earnings. Within each age cohort, those with the lowest resources face significantly negative average remaining lifetime tax rates and those with the highest resources face significantly positive average remaining lifetime net tax rates.

The study also concludes that current income is a very poor proxy for lifetime resources and current year net tax rates can provide a highly distorted picture of true fiscal progressivity. With the upcoming release of Minnesota's tax incidence study, which focuses exclusively on tax progressivity and all the accompanying fairness issues, this is an important idea to remember. Minnesota does an exceptional job addressing fairness concerns in its spending policies, and ignoring or discounting that reality for political purposes does a true injustice to the state. ■

29 "Is Uncle Sam Inducing the Elderly to Retire" NBER Working Paper No. 22770, October, 2016

30 "U.S. Inequality, Fiscal Progressivity, and Work Disincentives: An Intergenerational Accounting" NBER Working Paper No. 22032, February, 2016

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