Governor Walz and Lt. Governor Flanagan's 2026 Supplemental Tax Budget

Commissioner Paul Marquart

Responsible and Balanced Budget

- Fiscal Responsibility – balances the budget for years
  - Leaves $3.7 billion on bottom line for FY 2026-27
  - Leaves a remaining General Fund balance of $1.8 billion in FY 2028-29
  - Reduces the structural imbalance by almost 20% to $1.9 billion
- Addresses long-term budget challenges
- Makes responsible cuts and curbs growth in state spending
- Protects important investments into the future
- Creates more fairness and stability in the tax code
- Lowers costs for middle class families

Making Minnesota the Best State in the Nation for Children and Families

Largest Child and Dependent Care Credit in the Nation

"I have made it my mission to make Minnesota the best state in the country for a kid to grow up." - Gov. Tim Walz

Middle class families will see a tax cut of $150 million a year

<u>New "Young Child" Credit provides huge childcare savings for families – up to $6,000 credit</u>

- Families with children under 5 years of age will see a maximum credit of $3,000 for one child (was $1,050) and $6,000 for two or more children (was $2,100)

<u>Other new child and dependent care credit enhancements for families</u>

- Families with children 5 and older will see a maximum credit of $1,500 (was $1,050) and $3,000 for two or more children (was $2,100)
- 104,800 families (was 44,300) will qualify for the credit with an average <u>credit of $1,818</u>
- 61,100 families with dependents under 5 will see average <u>increase in credit of $2,061</u>

Greatly Enhancing Minnesota's Child and Dependent Care Credit

- Credit would be equal to a percentage of eligible employment-related dependent care expenses
- Credit equals 50% of eligible expenses, up from 35%
- Phase-out begins at $120,000 income and is completely phased-out at $170,000 income (was $15,000 and $88,150), is indexed for inflation beginning FY 2027
- 26 states and D.C have a child and dependent care credit
- Impact to the state general fund is estimated at $147 million in FY 2026-27 and $298 million in FY 2028-29

The Need for an Enhanced Child and Dependent Care Credit

Minnesota families are paying high childcare costs

Annual Costs	Metro		Greater Minnesota	
	Center	Family	Center	Family
Infant	$23,452	$11,752	$14,664	$8,684
Toddler	$20,644	$11,232	$13,260	$8,372
Pre-school	$17,732	$10,608	$12,012	$8,008
School-age	$16,016	$9,360	$10,348	$7,228

Source: ChildCare Aware of Minnesota, Updated November 2025

Typically, infant is birth to 1 year old, toddler 1 to 3, preschool 3 to 5, school age 6 and older

Benefits of Expanding the Child and Dependent Care Credit

Child and Dependent Care Credit:

- Recognizes parent's dual role of participating in the labor market and caring for dependents
- Enhances family wellbeing
- Reduces gender inequality leading to stronger workforce and economic growth
- Provides children with quality care when the parent is working
- Helps families afford quality professional care which supports child readiness, educational equality and long-term economic mobility

Maintaining Minnesota's Competitive Edge

Federal Conformity Recommendation

- Recent federal tax bill passed in July of 2025, H.R. 1
- Minnesota is a static conformity state, not a rolling conformity state
- State legislature must pass legislation to adopt or decouple from any provisions in H.R. 1

Revenue’s Priorities

- Minimize impact to customers
- Level of complexity for taxpayer compliance and tax administration
- Support voluntary compliance
- Provide guidance
- Protect integrity of the tax system
- Impact to state revenues

Federal Tax Conformity – Large Cost Items and Revenue Raisers

Large Conformity Cost Items in the Supplemental Tax Budget Proposal

- Modification of limit on business interest ($109.4, $55.9)
- Enhancement of dependent care tax credit ($16.0, $34.1)
- Increased dollar limitation for Section 179 ($36.2, $22.7)
- Exclusion for employer payments of student loans ($9.6, $20.7)
- Enhancement of dependent care assistance program ($5.0, $11.2)
- Extension of look-thru rule for Controlled Foreign Corporations ($4.5, $9.3)

Costs in millions FY 2026-27, FY 2028-29

Federal Tax Conformity – Large Cost Items and Revenue Raisers

Large Conformity Revenue Raisers in the Supplemental Tax Budget Proposal

- Enhancement of employee-provided childcare credit ($131.8, $241.6)
- 0.5% floor of deduction on individual charitable contributions ($19.9, $43.4)
- Bonus depreciation with 80% addition and subtractions over 5 years ($11.2, $40.3)
- Extension of deduction limitation for moving expenses ($9.8, $23.6)
- Limitation on excess business loss ($1.4, $29.0)
- 1 % floor on deduction on corporate charitable contributions ($0, $22.2)

Costs in millions FY 2026-27, FY 2028-29

Federal Conformity Recommendations

Large Conformity Cost Items NOT in the Supplemental Tax Budget Proposal

- Full expensing of domestic research and experimental expenditures ($349.1, $21.1)
- Exclusion of gain invested in a qualified opportunity zone ($47.0, $173.4)

Costs in millions FY 2026-27, FY 2028-29

Federal Conformity Revenue Estimate

	FY 2026-27	FY 2028-29
Supplemental Tax Budget Federal Conformity Proposal	($1.2M)	$268.4M
Exclude: Enhancement of Employer-Provided Childcare Credit	($127.8M)	$26.8M

Taxpayers will be required to amend their tax returns when conformity is enacted

Pass-through Entity Tax Extension

- Repeals the sunset for Minnesota's pass-through entity tax (PTE)
- Saves Minnesota businesses over $400 million each year in federal taxes
- Maintains current practices and adapts to recent federal tax changes
- This would align Minnesota's PTE tax with the new permanent status of the federal SALT tax cap
- Maintains the credit for PTE taxes
- Includes technical updates that address unintentional omissions of statutory references from 2023 law changes

Sustainable Aviation Fuel Investments: Providing Cleaner Air and New Jobs for Minnesota

- Expands existing Sustainable Aviation Fuel (SAF) Tax Credit administered by Department of Agriculture to support SAF production in Minnesota
- Recommendation includes enhanced tax credit of $0.02 per gallon of SAF for each additional 1% CI reduction beyond 50%, capped at $0.50 per gallon
  - This is additive to the existing $1.50 per gallon tax credit for SAF produced or blended in Minnesota (total cap $2.00 per gallon)
- Increased funding of $5.3 million in FY 2027 and in FY 2028, and $2.1 million in each fiscal year thereafter from the general fund until 2035
  - This increase will encourage private investment in the emerging SAF industry in Minnesota
- Proposal includes technical clarification pertaining to the definition of SAF feedstock and environmental safeguard updates

Modernizing Minnesota's Tax Code to the New Economy

Sales Taxes – Benefits of Cutting the Rate and Expanding the Base

Modernizes and right-sizes the sales tax code to match today's more service-oriented economy

- More tax fairness for consumers and businesses
- Creates a more stable and stronger revenue system
- Strong evidence in making sales tax less regressive

Lowers the Statewide Sales Tax Rate

- Decrease the state general sales tax rate from 6.500% to 6.425% (6.875% to 6.8%)
- Would be first sales tax rate cut in state history
- Business to business sales remain exempt
- Individuals and businesses will get a tax cut
  - Average family will see an annual sales tax cut of $32 (1.8%) with no use of expanded services
  - Businesses get a sales tax cut on all purchases they currently pay taxes on:
    - Materials, supplies and equipment for a construction project
    - General items – computer hardware and software, furniture, office equipment, safety equipment, hand tools
    - Construction machinery and equipment – bulldozers, excavators, forklifts, loaders

Currently Taxed Services in Minnesota

- Services currently taxed:
  - Landscaping
  - Laundry
  - Building cleaning
  - Pet grooming
  - Delivery
  - Motor vehicle towing
  - Admission and entry fees
  - Telecommunications

- Examples of services currently taxed:
  - Home cleaning from water damage after a fire or flood
  - Traffic control for funerals
  - Tree removal and cleanup after a storm or disaster
  - Towing motor vehicles out of a ditch
  - Cleaning clothing or linens for smoke or water damage

Right-sizing the Sales Tax to Match Today's Service Oriented Economy

Expanding the sales tax to some selected professional services:

Accounting Services: (including but not limited to)

- Audit, bookkeeping, payroll, financial statement preparation, tax return preparation services

Banking and Brokerage Services: (including but not limited to)

- Wealth management, safety deposit boxes, credit card fees, loan servicing, payment services, account maintenance fees, financial planning, retirement planning, trust management, investment planning

Legal Services: (including but not limited to)

- Attorney fees, paralegal services, law clerk services, notary fees, process serving, mediation and arbitration, title search

Services Excluded from Sales Tax Expansion

Excluded services from new expansion:

- Tax preparation for those claiming Child Tax Credit or Working Family Credit
- Banking origination fees, overdraft fees, late fees, and management of defined benefit pensions plans
- Legal aid services

Sales tax proposal budget impact:

Combined, these changes would raise an estimated $78.7 million of revenue in FY 2026-27 and $242.9 million in FY 2028-29 to the state general fund

Sales Tax Proposal Impact on Individual Taxpayers

Total Sales Tax Rate Cut (FY 2028)	**$96 million**
Total Services Expansion (FY 2028)	**$227 million**
Legal Services Expansion	$132 million
Accounting Services Expansion	$27 million
Financial Services Expansion	$68 million

Without Legal Services (10% of households)	
Tax Rate Cut	$96 million
Accounting & Financial	$95 million
Overall Sales Tax Change for 90% of households	**($1 million)**

Average household will see an annual sales tax cut

- Average household will see an annual sales tax cut of $32 (1.8%) with no use of expanded services
- Per household cost from the sales tax base expansion is $76
  - Legal Services ($44) - less than 10% of households
  - Accounting Services ($9) - about 25% of households
  - Financial Services ($23) - likely higher than 25% of households
- Consumer sees tax cut if purchases of selected services are under $470 ($470 times 6.8% = $32) (Not including other local taxes)

(Sources: Dept. Of Revenue Research , Bureau of Labor Statistics – Federal Consumer Expenditure Survey)

Social Media Data Collection Excise Tax – Preparing Minnesota's Economy for Artificial Intelligence

- Establishes a tax on the collection of consumer data by social media platform businesses and dedicates revenue generated to a special revenue fund
  - Consumer's data has a value. Social media platforms capture this data from consumers at no cost and use this data to generate profits
  - Social media tax gives some of this value back to the consumer
- Ensures workers and businesses are prepared to compete and succeed in a changing economy
  - $100 million a year in a special revenue fund will be dedicated to initiatives designed to prepare MN’s workforce and businesses for increased artificial intelligence adoption and other emerging technologies
  - Establishes Council on Artificial Intelligence Readiness. The Council will provide strategic guidance on how funds should be used
  - Revenues to this dedicated fund are estimated to be $47 million in FY 2026-27 and $197 million in FY 2028-29

Social Media Data Collection Excise Tax

- **Consumer** means an individual who establishes an account with a social media platform business or who accesses a social media platform through an account registered with a social media platform business, and whose data is collected by the social media platform business
- **Social media platform** means a for-profit social media platform that collects consumer data in support of the entity's business activities.
- Tax rate is based on the number of monthly active Minnesota consumers the platform collects data on:
  - 100,000 or fewer consumers, the tax is $0 per month.
  - Over 100,000 but not more than 500,000 consumers, the tax per month is $0.10 times the number of consumers over 100,000.
  - Over 500,000 but not more than 1,000,000 consumers, the tax per month is $40,000 plus $0.25 times the number of consumers over 500,000.
  - Over 1,000,000 consumers, the tax per month is $165,000 plus $0.50 times the number of consumers over 1,000,000.

Social Media Excise Tax – Tax Code Not Keeping Up With Digital Economy

Differences between Traditional and New Large Internet Business Models

<u>Traditional Tax Business Model</u>

- Business sells goods and services to consumers to earn <u>profits.</u> These transactions <u>are taxed (sales or excise)</u>
- Companies pay taxes on minerals extracted from Minnesota land which generates profits
- Profits earned through <u>tangible</u> resources made in <u>factories</u>

<u>New Large Internet Tax Business Model</u>

- Social media platform provides "free services" (searching the web) to consumers who watch advertisements and provide data which generates <u>profits</u>. These transactions <u>are NOT taxed</u>
- Social media platforms pay no taxes on data extracted from Minnesota consumers which generates profits
- Profits earned through <u>intangible</u> resources made in the <u>cloud</u>

Social Media Excise Tax – The Need to Update our Tax Code

New Large Internet Business Model Creates:

- Large state tax gap
- Unlevel playing field for traditional tax model businesses
- Increased costs to similar service businesses
- Less funding for important state services to citizens

Social Media Tax:

- Updates Minnesota's tax code to match today's economy
- Levels the playing field for all businesses providing similar services
- Lowers costs for all businesses and taxpayers
- Investments to help MN remain a leader in innovation while ensuring workers and businesses can benefit from AI and technological changes

Additional Priorities

Gross Receipts Tax on Firearms and Ammunitions

- Part of Governor Walz's comprehensive Gun Violence Prevention, Safety, and Security proposal
- Creates a 10% gross receipts tax on the sales of handguns and an 11% gross receipts tax on the sales of long guns and ammunition
  - New tax would be imposed on firearms and ammunitions retailers
  - Does not apply to the purchases of individual components to make, modify, or repair firearms or ammunitions
  - Exempts purchases made by law enforcement agencies and the National Guard
- Mirrors the federal Firearms and Ammunition Excise Tax
- Estimated to raise $9.2 million in FY 2026-27 and $28.2 million in FY 2028-29 to the state general fund

Sales Tax Exemption Reciprocity for Medical Cannabis

- Currently, the 15% gross receipts tax on cannabis does not apply to the sale of medical cannabis purchased by or for a patient enrolled in the state registry program
- Proposal expands medical cannabis exemption to include individuals in a tribal registry program who purchase medical cannabis off-reservation at a state-licensed medical dispensary
- Establishes a reciprocal exemption for tribal registry patients making these purchases and resolves the unintended disparity
- Cost to state general fund is estimated at $30,000 in FY2026-27 and $90,000 in FY2028-29

Aligning the Cannabis Statutes to Sales Tax Statutes:

- Clarifying Cannabis Sales Tax Return Cycles
- Reference correction for medical cannabis paraphernalia
- Clarifying credit for cannabis gross receipts tax paid
- De minimis exemption for hemp and cannabis carried into the state
- Cannabis posting new license types
- Medical cannabis definition and sales tax exemption clarification

Historic Structure Rehabilitation Tax Credit Completion Limit

- Proposes removing the state tax credit's three-year timeline from when an allocation certificate is issued to when the project must be completed
- Would allow applicants to be consistent with timing of federal historic tax credit projects (up to 60 months), which applicants must be eligible for and receive in order to be eligible for the state credit
- Reduces complexity and pressure for applicants by restoring the state process for issuing allocation certificates and credit certificates in conjunction with the federal timeline
- No cost to state general fund estimated within current forecast window

New Corporate Franchise Tax Division Passthrough Audit Unit

- Request: $855,000 in FY 2026-27; $1,833,000 ongoing to fund 13 FTEs for a new unit
- Establishes an additional audit unit at Revenue dedicated to complex pass-through audits
- New unit would review growing complexities associated with pass-through entities and increase Revenue’s ability to effectively audit
- Requires initial investment in FY 2026-27 but FY 2028 and ongoing there is an estimated positive fiscal impact that will be greater than the cost

MN DEPARTMENT OF REVENUE

Thank you!