

Updated: 01/26/2011 10:06:27 PM

Fix for Minn. budget woe? End sales tax exemptions

With Minnesota lawmakers staring at a \$6.2 billion deficit this session, state Rep. Pat Garofalo knows as well as anyone that balancing the state budget is "going to be tough and it could be ugly."

So why is the Republican from Farmington introducing a bill that would make things just a tiny bit worse, by exempting animal shelter pets from the statewide sales tax?

"At the end of the day, I like puppies and kitties," Garofalo said.

His proposal would cost the state only a little money \_ easily less than a million dollars a year, he estimates. But it would add yet another carve-out to the state's tapestry of sales tax exemptions, 83 special deals on everything from staples like food and clothes to more oddball exceptions like horses, used motor oil and the machines used to make fake snow at ski hills.

In fact, Minnesota lawmakers could wipe out that \$6.2 billion deficit at once if they repealed every single sales tax exemption. Figures from the Department of Revenue show plugging those 83 exemptions would dump \_ you guessed it \_ just about \$6.2 billion into the state treasury over the next two years. Another \$5.3 billion would be up for grabs if lawmakers mustered the political will to apply the sales tax to several dozen services that are also exempt, from hiring lawyers and accountants to paying for funerals and safe deposit box rental.

But it's easier said than done.

Plenty of state lawmakers and even former governors have tried to pare back the exemptions but run into a political brick wall. Similar efforts to do so in other U.S. states \_ most have dozens or more exemptions on the books \_ have failed, too.

"Why is it that, if you're a tool maker and I own a law firm, your product is taxed and mine is not?" said state Rep. Melissa Hortman, D-Brooklyn Park. "We both drive on the same roads. Our kids go to the same schools. But your business has to take more out of its bottom line than mine does to keep up with the sales tax."

In 2008, Hortman introduced a bill to eliminate all state sales tax exemptions and correspondingly lower the overall sales tax rate. "I couldn't even get one co-sponsor," she said. In 2001, former Gov. Jesse Ventura proposed eliminating some exemptions and bringing down the total rate. It went nowhere, and in 2009 a tax reform commission convened by Gov. Tim Pawlenty offered much the same idea. Nothing came of it.

Last year, independent candidate for governor Tom Horner tried again with a similar proposal in his campaign platform. He finished a distant third. State Sen. Tom Bakk, a failed Democratic candidate for governor last year, got no traction for his proposal to add the sales tax to clothing.

That alone would raise about \$600 million in 2011-12, but the 43-year-old exemption has proved tenacious in this home to the Mall of America.

Even more costly is the exemption for food, which if taxed would raise nearly \$800 million in 2011-12. Lifting the exemption on drugs and medicine would generate \$565 million over those two years; adding the sales tax to residential heating fuels, used motor oil, and a small mix of exempt tools and equipment would generate nearly \$300 million.

"They don't get repealed often," said Carl Davis, senior analyst at the Institute on Taxation and Economic Policy, a Washington-based nonprofit that advocates progressive taxation. "In most cases, exemptions are heavily beneficial to a very interested and vocal minority that is willing to heavily invest in hanging on to them."

In Rhode Island, new Gov. Lincoln Chaffee has proposed a 1 percent sales tax on items currently exempt from that state's 7 percent sales tax to help close the budget gap there. In its annual State and Local Tax legislative outlook, the national accounting firm Grant Thornton LLP predicted recently that more states would look to broader sales tax bases as a way to get out of budget jams.

There's been no such proposal so far in Minnesota, where Democratic Gov. Mark Dayton wants to raise the income tax rate on high earners as his major weapon for fixing the budget. The Legislature's Republican majority, meanwhile, wants to do it with spending cuts.

But later this week, the Senate Finance and Tax committees will comb through the Department of Revenue's tax expenditure report, which details the breaks. Sen. Claire Robling, chairwoman of the Finance Committee, said an initial read shocked her \_ and helped her see an alternative approach to fixing the budget problem.

"We are giving up a ton of revenue here," said Robling, R-Jordan. "We're looking for our best bang for the buck, in a time where we really need job creation. Maybe we should be looking at some of these exemptions and asking if they are really bolstering economic growth. If they're not, maybe something else might be more effective."

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Online:

Minnesota Department of Revenue Tax Expenditures Budget (sales tax exemptions detailed starting page 99):

[http://taxes.state.mn.us/legal\\_policy/Documents/other\\_supporting\\_content\\_2010\\_tax\\_expenditure\\_links.pdf](http://taxes.state.mn.us/legal_policy/Documents/other_supporting_content_2010_tax_expenditure_links.pdf)

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