

Minnesota Legislative Update: Two Steps Back

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When the Minnesota Legislature convened in February, the state had just announced a modest budget surplus. Lawmakers and Governor Mark Dayton were optimistic that they could reach agreement on a capital investment bill, a tax bill conforming to recently enacted federal tax reform, and other pressing issues including opioid abuse, MNLARS, the state's troubled vehicle title and registration system, elder abuse, and school safety. The session came to an end a little before midnight on Sunday, May 20, when the Legislature adjourned sine die without an agreement with the Governor on federal conformity, a supplemental budget bill, bonding bill, or any legislation addressing the other handful of pressing issues. Governor Dayton subsequently vetoed both the federal conformity and supplemental budget bills, representing the bulk of the Legislature's work this session. The Governor has yet to take action on the bonding bill.

The following is a summary of what happened at the Legislature in 2018.

Bonding Bill

In January, Governor Dayton proposed a bonding bill of approximately \$1.5 billion dollars and identified another \$858 million dollars of local projects that he believed had merit. The Governor's proposal focused on higher education and water and wastewater facilities. Until the final days of session, the House and Senate had yet to pass a bonding bill, although each had separately agreed to bonding targets of approximately \$825 million in general obligation bonding, only half of what the Governor had requested.

After significant negotiations over the final weekend of session, especially in the Senate where a proposal had been voted down earlier in the week, the Legislature passed and sent to the Governor a \$1.43 billion bonding bill. Of the \$1.43 billion, \$825 million is general obligation bonding. The remaining comes from trunk highway bonds, the Minnesota Rail Service Improvement Fund, the general fund and the Environment National Resources Trust Fund.

The bonding bill includes \$543 million for state roads and bridges, but zero dollars for transit. It also includes about \$180 for higher education, significantly lower than the \$542 million proposed by the Governor. Additional bonding items include \$32 million for new veterans' homes, \$28 million for mental health crisis centers, and \$90 million for water and wastewater needs across the state.

It is anticipated that the Governor will make a decision on the bonding bill next week.

Supplemental Budget

A session's worth of work was largely condensed into one supplemental budget bill that was ultimately vetoed by Governor Dayton. This bill, HF4099/SF3656, weighed in at almost 1000 pages, spent almost \$135 million, and, at one point, contained more than 200 policy proposals.

The bill spent about \$76 million this year, primarily on education, health and human services, public safety and broadband. Another \$58 million was spent on transportation, primarily roads and bridges.



The bill's wide-ranging policy provisions covered almost every area of state government. It tackled opioids and elder care; it reallocated U.S. Bank Stadium's stadium reserve account; it enhanced criminal penalties for those intentionally obstructing traffic and child pornography crimes; it prohibited the adoption of new nitrogen rules by the Minnesota Department of Agriculture, and prohibited the MPCA from enforcing the state's wild rice water quality standard without going through a new rulemaking process. It also established an account in the remediation fund for the \$850 million settlement following the state's lawsuit with 3M. The amount available after legal expenses, an estimated \$720 million, would be appropriated to the MPCA and DNR to enhance the quality and sustainability of the drinking water in some parts of the eastern Twin Cities metropolitan area. After much debate regarding the "hands-free" bill, the conference committee also adopted an enhanced penalty for texting while driving.

House and Senate conferees spent almost two weeks working to reach agreement while negotiating with Governor Dayton. At one point Governor Dayton sent conferees a list of 117 objections to the bill. In response, conferees either removed or modified more than half of these items in hopes the Governor would be inclined to sign the bill into law.

During the final week of session, Governor Dayton repeatedly pledged to veto the supplemental budget bill if it contained policy provisions he could not accept and certain agency cuts were not restored. He also asked that some shared priorities — like opioids, elder care and school safety legislation — be negotiated separately and sent to him as stand-alone bills. These requests were not accommodated and on Wednesday, May 20, the Governor vetoed the supplemental budget bill. [Read the full veto letter.](#)

Tax Bill

Since passage of the Tax Cuts and Jobs Act of 2017 (TCJA), tax conformity has been a prominent topic of discussion at the Minnesota Legislature. Without any action by the legislature, roughly 300,000 Minnesotans would see a tax increase, and filing state taxes would become quite complicated. Both the Governor and the legislature supported a tax plan that conformed to many, but not all, of the federal changes. Both plans also offered tax relief to many individual taxpayers who would experience tax increases based on the federal changes. The legislature also enacted tax reductions for businesses, while the Governor proposed conforming to some provisions beneficial to business, but increased business taxes in several key areas.

The legislature passed [HF947](#), which would conform to many TCJA provisions and provide roughly \$140M in tax relief in 2018-19 and \$43M in 2020-21. The bill passed the House with a bipartisan vote of 85-42 and the Senate 34-33 along party lines. The bill does not include three provisions from the 2017 Omnibus Tax Bill Governor Dayton signed regarding C/I levy, estate tax and tobacco provisions.

Individual Income Provisions

HF947 changes the starting point for filing Minnesota taxes from Federal Taxable Income to Federal Adjusted Gross Income, which is the same as 30 other states. This change will maintain a simple filing system for taxpayers. The bill protects 99.8 percent of taxpayers from tax increases, and 82 percent will see a decrease. This is achieved primarily by reducing the individual income tax rates for tier one and tier two from 5.35 percent to 5.25 percent and 7.05 percent to 6.85 percent, respectively.

Business Tax Provisions

Businesses will retain Federal Taxable Income as the starting point for filing Minnesota taxes. The bill provides tax relief by lowering the corporate rate from 9.8 percent to 9.1 percent and removing the corporate AMT. It also fully conforms to Section 179, including removing the 80 percent add back, and includes \$5 million of one-time funding for the angel investor credit. The bill does not conform to foreign earnings in the TCJA, but allows deemed repatriation.

Governor Dayton Concerns

On Wednesday, Governor Dayton vetoed HF947, citing misguided tax priorities. He said the bill is similar to the TCJA regarding providing greater relief to corporations and the richest Americans than to working class Minnesotans, referencing the difference in rate cuts. Governor Dayton's veto letter expressed disappointment



that the Legislature didn't fully conform to foreign income portions of the TCJA, which would have provided revenue to expand the Working Family Credit and create a dependent credit. Fiscal stability of the state's budget has been a staunch priority for the Governor, who believes H.F. 947 will make the budget less stable in the future. [Read the full veto letter.](#)

The Governor's veto means Minnesota taxpayers will have a complex filing for 2018, and many taxpayers will see a tax increase. Some legislators have suggested calling a "lame duck" session after the elections to consider a scaled-back conformity bill that addresses some of these filing issues. The Governor has not closed the door on this idea. Unless the Governor calls a Special Session, this issue will be a significant priority when the Legislature reconvenes in January 2019.

Transportation Constitutional Amendment

In the final days of session, House Republicans passed a proposed constitutional amendment allocating all sales tax revenues from motor vehicle parts and repairs to the state's highway construction fund. A portion of these sales taxes were statutorily dedicated last session. Prior to 2017, they were funneled into the state's general fund. The proposed amendment, contained in [HF4437](#) and authored by Rep. Paul Torkelson (R-Hanska) passed off the House floor 76-54.

Lawmakers, Governor Dayton and transportation officials all agree that adequately funding the state's transportation needs requires billions of dollars, but have differed on the best funding approach. Supporters of the House Republicans' approach have argued that most other states use general fund revenue to fund transportation, and that a constitutional dedication brings budget certainty. Opponents argue that using the general fund detracts from other priorities, like education, and is nowhere near sufficient to address the need. They believe a gas tax increase is a better approach. Metro DFLers also criticized the lack of transit funding in the plan.

While the bill passed a number of Senate Committees, it was not brought up for a vote on the Senate floor and, as a result, will not be on the ballot this fall.

Pension Reform Passes

The very last bill passed in the 2018 Session, less than 15 minutes before adjournment, was the Omnibus Pension and Retirement Bill. Previous attempts at reform had been vetoed by Governor Dayton. In 2016, the Governor said he vetoed the bill because it contained "only one piece of the overall sustainability plans, placing sole responsibility for reducing plan liabilities on current retirees." In 2017, he vetoed the bill because of the labor standards that would preempt local governments' ability to set wage and benefit levels higher than state law.

This year's version, authored by Sen. Julie Rosen (R, Vernon Center) and Rep. Tim O'Driscoll (R, Sartell), contains a number of reforms including ending augmentation for early retirees, postpones the state of post-retirement adjustments until the normal retirement age, reduces the COLA increases applied to retirees benefits and makes changes to actuarial assumptions, including assumptions for investment rate of return. It also increases employer and employee contributions.

The pension bill passed both the House and Senate unanimously. It is believed that Governor Dayton supports the bill and will sign it in the next week.

Looking Forward to November

With the legislative session completed, all eyes will focus to the 2018 election, where voters will decide on a number of different races, including two U.S. Senate seats, all eight congressional seats, the Governor's Office, the state's other constitutional officers and the Minnesota House of Representatives. The Minnesota Senate is not up for re-election until 2020. However, Senate President Michelle Fischbach announced her retirement from the Minnesota Senate today to become Minnesota's next Lieutenant Governor, a vacancy created when Senator Tina Smith was appointed to fill the vacancy created by Senator Al Franken's resignation late last year. With Senator Fischbach's resignation, the Minnesota Senate is now split 33-33 between Democrats and Republicans. A special election to fill this vacancy will occur concurrently with the general election in November and will determine control of the Minnesota Senate in 2019.

