

Tax Section News

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Chair's Report

By Don Brown, Cargill, Incorporated

As this is my last Chair's Report, I would like to express appreciation to some of the many individuals who have made this another successful year for the Section.

I would like to first thank Fran Holmes, who is now with the IRS Office of Chief Counsel. She was very helpful to me as various issues arose and was a terrific sounding board. Fran also served as chair of the planning committee for the 2005 Tax Institute. In addition to the work Fran and the planning committee put into the Institute, Tara King, Mary Acciari and Lynne O'Connell from Minnesota CLE also were instrumental in making the 2005 Tax Institute a great success. I believe the Institute gets better every year because of the time and effort put in by the individuals who plan the conference and the outstanding presenters.

Two individuals at the MSBA have been invaluable during my year as Chair: Mary Kempton and Kim Basting. The job of Chair would be very difficult without the terrific service they both provide.

We once again hosted some excellent one-hour CLEs at our monthly meetings and I would like to acknowledge our presenters: John James, Lommen, Abdo, Cole, King & Stageberg, P.A.; Tom Hesse, Minnesota Chamber of Commerce; Alan Gregerson, Internal Revenue Service; Stephen Krenkel, Minnesota Department of Revenue; John Knapp, Winthrop & Weinstine, P.A.; Judge George Perez, Minnesota Tax Court; Leela Rao, 1031 & TIC Investments, LLC; and Cindy Nosan, 1031 Exchange Services. Your efforts to keep members updated on the most current developments in the tax area are most appreciated. We continue to explore ways of making these events accessible for all members of the Section, specifically, using the new webcast facilities at Minnesota CLE.

Heather Broneak, Larson, Allen, Weishair & Co., LLP and Dan Kidney, PricewaterhouseCoopers LLP did an excellent job this year on the Tax Section News. I believe we have one of the best periodicals and it is the result of these two individuals and the individuals who contribute articles and columns. In addition to specifically acknowledging the efforts of both Heather and Dan, I want to also thank Jerry Geis for providing us with the Pending Minnesota State Tax Cases write-ups. In order to prepare his summaries, Jerry makes a trip to the Minnesota Tax Court every month and reviews the most recent filings. As he has done for many years, Jerry provides a real service to this Section.

Tax Section Officers and Council Members

At our May meeting, the Council nominated the following individuals for election as Section officers for 2006/2007: Chair: Yuri Berndt, Moss & Barnett, P.A.; Vice Chair: Robert Stuart, Fredrikson & Byron, P.A.; Treasurer: Heather Broneak, Larson, Allen, Weishair & Co., LLP; and Secretary: Gina DeConcini, Deloitte & Touche, LLP.

Nominated as new members for two-year terms are Jed Larkin, 3M; Patrick Butler, Krass Monroe, P.A.; Barry Clegg, Rider Bennett, P.A.; and Christina Cook, Legal Aid Society of Minneapolis. Nominated for re-election to two-year terms are Heather Broneak and Jerry Geis. Terry Costello, Lindquist & Vennum, PLLP was nominated to complete the second year of Jon Peterson's term. I believe that these nominated individuals, along with returning members Peter Fuchsteiner, Tom Muck, Yuri Berndt, Gina DeConcini and Bob Stuart, will serve the Section well.

Tax Section News

Heather Broneak has served as editor of the Tax Section News for several years. She also has served on the Tax Section Council this past year. Heather has been nominated to serve as Treasurer for the 2006/2007 Council, so we need to find a new editor to work with Dan Kidney on the Tax Section News.

For those of you who are new to the practice of law and/or the Section, this is a great way to get your name out in the community. The duties of editor are to send out solicitation letters to the regular contributors and edit these articles and any other articles that are sent in. If you are interested, please contact me at (952) 742-6780 or don_j_brown@cargill.com.

2006 Tax Institute

We will be meeting in June to plan the 2006 Tax Institute. The dates have not yet been finalized, but the event will take place sometime in November. The past-Chair of the Section traditionally serves as chair of the planning committee, so that duty falls to me this year. As I wrote above, the Tax Institute is a success partly because of the planning that takes place. As chair, I would like to invite you to join the planning committee. There are approximately three meetings that take place during the summer, and the planning committee's duties are simply to arrange the speakers, and the staff at Minnesota CLE take care of the rest. Please contact me if you are interested in being on the planning committee or if you just have some ideas of the topics you would like covered at the Institute.

Mid-Minnesota Legal Assistance (MMLA) Tax Project Grant

At our April meeting, the Tax Council voted to contribute \$3,000 to the Mid-Minnesota Legal Assistance (MMLA) Tax Project. Christina Cook wrote an article for the Winter 2006 issue of the Tax Section News that explained the need for the grant. The contribution will be combined with a matching work-study contribution of \$9,000, which is sufficient to fund a part-time clerk position. The clerk will also be preparing articles for the Tax Section News.

Finally

I am grateful for the opportunity to serve as Chair of this outstanding Section. We have many outstanding tax practitioners in this group. For those of you that have not been very active in the Section in the past, I would encourage you to do so. I have found that what I have gotten back from this Section was well worth the time and effort I have put in.

IRS Column

Submitted on behalf of Faris Fink, Area Director, SBSE Compliance, and Shane Ferguson, Territory Manager, SBSE Taxpayer Education & Communication (TEC)

Employee Plan Information

IRS Employee Plan Customer Education and Outreach provides monthly information on employee plans. To view this information, visit the IRS web site at <http://www.irs.gov/ep>.

“Electronic IRS”

To mark the milestone of 20 years of IRS e-file, the IRS has launched the Electronic IRS, a centralized source for all IRS electronic options. Taxpayers and tax preparers who click on the Electronic IRS Logo, located at <http://www.irs.gov>, will be taken to a page that contains an overview of all the electronic tasks that can be accomplished online.

The Electronic IRS is a one-stop option for both taxpayers and tax preparers, providing access to information about e-file and numerous internet options. For taxpayers, the Electronic IRS provides access to “Where’s My Refund?” where they can check the status of a refund, find an IRS e-file provider, check their eligibility for the Earned Income Credit, download tax forms, sign up to pay electronically or obtain an employer identification number.

Subscribe to e-News for Tax Professionals— The IRS’ Electronic Newsletter for the Tax Professional Community

IRS E-News for Tax Professionals is an electronic subscription newsletter designed to provide up to the minute, national and local IRS news to the tax professional community. E-news is generally distributed on the first and third Monday of each month. It is FREE.

E-news is available FREE to tax professionals nationwide; it is easy to subscribe on IRS.gov. Click on “Newsroom,” “e-news Subscriptions,” and “Join e-News for Tax Professionals.”

Case Reference by ACS

The Automated Collection System (ACS) determines the balance due and the non-filer cases requiring telephone contact for resolution. ACS enables the IRS to contact taxpayers by telephone and collect delinquent taxes.

Collection employees use ACS as a case management tool to contact taxpayers, review case histories, and issue notices, liens, or levies to resolve the cases.

Tax practitioners with a valid Power of Attorney (POA) on file may be contacted by ACS directly about their client’s tax deficiency. The IRS has updated the ACS system to enable tax practitioners to be the first contact for ACS issues instead of the taxpayer if a valid POA exists.

The ACS system issues a Case Reference Number (CRN) rather than the SSN or EIN to tax practitioners with a valid POA on file for that client. ACS personnel will access the taxpayer’s account by using the CRN.

When returning these calls, the practitioner can contact Practitioner Priority Service (PPS) for routing to ACS (Option 3), or contact ACS directly at 1-800-829-3903 or 1-800-829-7650. The tax practitioner will not receive a prompt for entering a SSN or EIN. The tax practitioner should remain on the line without entering

anything at the SSN/EIN prompt. By holding, the tax practitioner will automatically be placed in a queue to speak with a Collection employee that can access the account information using the CRN.

Issue Management Resolution System (IMRS)

In a continuous effort to increase tax compliance, it is essential that the Internal Revenue Service uses every opportunity to foster its relationships with external stakeholders. A crucial component of these relationships is the IRS ability to identify, address and track issues that concern its stakeholders.

The IMRS, recently established by the IRS Stakeholder Liaison function, was designed to capture, develop, resolve, and respond to significant national and local stakeholder issues in a timely manner. IMRS provides a vehicle for stakeholder organizations to forward information about IRS policies, practices, and procedures that may be negatively impacting taxpayer compliance or IRS services.

The identified issues will be researched to bring about the resolution. Other operating divisions and functions will be contacted for input as needed to resolve stakeholder issues with their organizations. IMRS will also identify trends in the reporting, filing and paying requirements that may necessitate changes to IRS outreach as well as to processes and procedures.

Your local Stakeholder Liaison office is available to address your questions and input through the IMRS program. You can use the following list of Stakeholder Liaison contacts to establish a relationship with your local office and take advantage of the program: http://www.irs.gov/pub/irs-utl/sl_local_contacts.pdf.

Tax Information in Spanish

If you need federal tax information in Spanish, the IRS provides free Spanish-language products and services. Pages on the Internal Revenue Service’s Web site, pre-recorded tax topics, refund information, tax publications and toll-free telephone assistance are all available in the Spanish language.

The Spanish-language page (El IRS en Español) on the IRS Web site is located at <http://www.irs.gov/espanol>. You will find links to tax-related information like forms and publications, warnings about tax scams that victimize taxpayers, information on the Earned Income, Child and various other tax credits, and more.

TeleTax is a toll free, automatic telephone service available in English and Spanish. TeleTax provides helpful pre-recorded tax topic messages and refund information. You can find a list of over 150 TeleTax topics in the instructions for the Form 1040, 1040A, or 1040 EZ. TeleTax can also help you if it’s been at least four weeks since you filed your tax return and you want to check on the status of your federal refund. Having a copy of the tax return handy will help you respond to the prompts on the automated system. TeleTax is available 24 hours a day, 7 days a week at 1-800-829-4477.

Spanish Publications are available by calling 1-800-TAX-FORM (1-800-829-3676) or on the IRS Web Site, <http://www.irs.gov>.

Toll-Free Telephone Assistance is available from Spanish-speaking representatives by calling the IRS customer service line at 1-800-829-1040.

Utility Rule Changes Could be Near

By Dan Salomone, Commissioner, Minnesota Department of Revenue

In 2004, the Department of Revenue, noting an alarming uptick in litigation relating to utility property valuations, committed to review and update Minnesota's Utility Rule. The current rule (Minnesota Rules, Chapter 8100), which has not been reviewed since the mid-1970s, pertains to the valuation and assessment of utility property such as electric, natural gas, and pipeline generation, transmission, and/or distribution.

The threat of potentially disruptive court decisions that could suddenly deprive highly utility-dependent communities of significant property valuation and shift taxes to other classes of property motivated the Department to undertake the review. Additionally, a growing number of appeals have led to property valuation by negotiation rather than by rule, undermining the fairness of the valuation process.

Our thinking was that a thoughtful review, done in consultation with local governments and the utility industry, would facilitate a more orderly transition from our current rule to something more modern, more flexible and ultimately more defensible.

The review process started in late 2004 when the Department contracted with Brent Eyre, a nationally recognized expert in the assessment of utility property, to evaluate our current rule and recommend improvements.

Eyre's comprehensive review concluded that, compared to other states, the rule is rigid and formula-driven, with significant issues dating back three decades. In its current form, the rule undermines appraiser judgment, disallows the use of the market approach (which is one of the three basic ways to determine value, the other two being the income approach and the cost approach), puts a cap on depreciation, and prescribes weights in reconciling the income (25 percent) and cost (75 percent) approaches to value.

From the start, the Department's goal was to work closely with all of the stakeholders affected by the Utility Valuation Rule to identify changes that could be supported by a majority of stakeholders. Ideally, a new rule would provide more clarity and fairness to utility companies and their host communities.

Using the consultant's report and feedback from two public forums held in March and July of 2005, the Department identified four principles to guide changes to the rule:

- Keep an analytical separation between the derivation of a new rule and its tax effects. The Department's responsibility is to get the valuations right. The governor and the Legislature are responsible for setting the tax burden of utility properties and the revenue base of local communities. We need to advise them of the rule's tax implications in a timely manner so that they can reevaluate utility tax policy if they so choose.
- Strike a reasonable balance in the rule between being prescriptive and allowing sound appraisal judgment.
- Address concerns related to predictability and stability (in terms of economic factors and changes due to litigation) in estimating market value.
- Create an easily understood and easily administered rule.

We established an advisory committee consisting of seven members from the industry and seven members of the host communities. These hardworking individuals have met regularly over the past six months to discuss, dissect and comment on Eyre's findings and our proposed rule changes.

Those changes could now be only a few months away. The current plan is to use the new rule for determining assessment year 2007 values, for taxes payable in 2008.

A finalized draft rule will have been presented by the time you read this and public comment will have ensued. Next, the Department of Finance and the Governor will have an opportunity for review.

We expect to publish the rule in June, and again, solicit public comment and hold a public hearing on the rule.

If the proposed rule changes are approved by the Governor, we expect to publish the adopted rule by November .

The Department of Revenue remains committed to keeping this process transparent and inclusive for all of the stakeholders.

We are encouraged by the process and its results to date. Our goal of bringing clarity and stability to this rule, after nearly three decades of neglect, is finally in view.

Dan Salomone is the Commissioner of the Minnesota Department of Revenue.

Pending Minnesota State Tax Case Summaries

Spring 2006

By Jerry Geis, Briggs & Morgan

MAPLEWOOD TERRACE OF ISLE

Minnesota Tax Court Docket No. 7829

Taxpayer's Counsel

Pro se

Filed: March 7, 2006

DOR's Counsel

- Issue:
1. Whether taxpayer is an "owner entity" as defined in Code of Federal Regulations title 24, part 941.604, for a qualified low-income housing project described in paragraph (b), clause (5) of Minn. Stat. § 297A.71, Subd. 23.
 2. Whether taxpayer qualifies under Revenue Notice #05-09: Sales & Use Tax/Low Income Housing Exemption/Owner.
 3. Whether taxpayer, who is a developer, who isn't a partnership with PHA ("Public Housing Agency") or who doesn't have a ground lease with a PHA can qualify for the exemption under Minn. Stat. § 297A.71, Subd. 23 as an "owner entity", when the PHA has no ownership interest in the low-income housing units.

Years: Refund claims for taxable periods June 1, 2001 through and including December 31, 2001

Amount: Unstated.

Status: **Awaiting Return Answer from Commissioner.**

JAMES E. & VICKI L. KOLLROSS

Minnesota Tax Court Docket No. 7830

Taxpayer's Counsel

Pro Se

Filed: March 9, 2006

DOR's Counsel

- Issue:
1. Whether Vicki Kollross was an employee of REC Inc. and/or Minnstar Builders Inc. rather than an independent contractor for the individual tax periods of 2002 and 2003.
 2. Whether taxpayers, who allege they are residents of the State of Wisconsin, should have been taxed in Wisconsin rather than in Minnesota for the tax periods 2002 and 2003.

Years: Individual income tax returns for 2002 and 2003.

Amount: \$41.59 and \$35.46

Status: **Awaiting Return Answer from Commissioner.**

UNITED TACONITE LLC v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7831

Taxpayer's Counsel

John W. Windhorst, Jr.

Jerome A. Geis

Filed: March 9, 2006

DOR's Counsel

- Issue:
1. Whether the Commissioner erred in including a predecessor's taconite production for 2003 in the determination of United Taconite LLC's 2005 tax liability because Minn. Stat. § 298.24, Subd. 1, does not authorize either the inclusion of production by persons other than United Taconite in the determination of United Taconite's tax liability or the collection from United Taconite of a liability of a bankrupt predecessor taconite company.
 2. Whether the Commissioner erred in including a predecessor's production for 2003 in the determination of United Taconite LLC's 2004 tax liability because the inclusion of such pre-sale production in the determination of United Taconite's tax liability violates the Bankruptcy Code (11 U.S.C. § 363) and the sale order (Paragraphs F, G & H).

Years: Taconite Production Tax of United Taconite LLC for the taxable year 2005.

Amount: Excess tax over \$6,371,944

Status: **Awaiting Return Answer from Commissioner.**

UNITED STATES STEEL CORPORATION v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7832
Taxpayer's Counsel
John W. Windhorst, Jr.
Jerome A. Geis

Filed: March 9, 2006
DOR's Counsel

- Issue:
1. Whether the Commissioner erred in including a predecessor's taconite tax production for 2003 in the determination of United States Steel Corporation's 2005 tax liability because Minn. Stat. § 298.24, Subd. 1, does not authorize either the inclusion of production by persons other than United States Steel Corporation in the determination of U.S. Steel's tax liability or the collection from U.S. Steel of any liability of a bankrupt predecessor taconite company.
 2. Whether the Commissioner erred in including a predecessor taconite company's 2003 production in the determination of United States Steel Corporation's 2005 tax liability because the inclusion of such pre-sale production in the determination of U.S. Steel's tax liability violates the Bankruptcy Code (11 U.S.C. § 363) and the sale order of the Bankruptcy Court (Paragraphs N, P & 8).

Years: Taconite Production Tax of United States Steel Corporation
for the taxable year 2005.

Amount: Excess tax over \$9,388,952.

Status: **Awaiting Return Answer from Commissioner.**

JAMES H. MARONDE v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7833
Taxpayer's Counsel
Pro se

Filed: March 20, 2006
DOR's Counsel

- Issue:
1. Whether taxpayer is personally liable for the withholding tax for Trusted Mortgage Company, Inc. for the quarters ending September, 2004 and December, 2004.
 2. Whether the taxpayer can avoid personal liability since the accounting and business decisions were completely turned over to a business consultant in July, 2004 and the taxpayer terminated his employment as CEO of Trusted Mortgage Company, Inc. on August 31, 2004.

Years: Withholding tax for quarters ending September, 2004 and December, 2004.

Amount: \$16,454.87.

Status: **Awaiting Return and Answer from Commissioner.**

RONALD W. DVORACEK v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7834
Taxpayer's Counsel
Pro se

Filed: April 5, 2006
DOR's Counsel

- Issue:
1. Whether taxpayer is personally liable for payment of withholding tax for Midwest Demolition Services, Inc. for the tax periods ending 2004 and 2005.
 2. Whether taxpayer is relieved and absolved of liability because he resigned his position as an officer/employee, resigned as a member of the Board of Directors, and was not listed or involved in the opening of a new business checking account by Company on or after October 8, 2003.

Years: Withholding tax for quarters ending July, 2005 and December 2004.

Amount: \$11,691.78

Status: **Awaiting Return and Answer from Commissioner.**

STUDIO TAN INC. v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7835
Taxpayer's Counsel
Saul A. Bernick

Filed: April 17, 2006
DOR's Counsel

- Issue:
1. Whether taxpayer is subject to sales and use tax for the periods January 1, 2000 through and including September 30, 2004.
 2. Whether the statute of limitations for assessment purposes expired for all months prior to August 2002.
 3. Whether the statistical sampling for the air brush average sales was proper and appropriate for the first quarter of 2003 since the air brush business did not commence until sometime during the first quarter of 2003.
 4. Whether the air brush sales are a service and are therefore not subject to sales and use tax.
 5. Whether the statistical sampling for the sales is inaccurate because (i) package services include sales tax; (ii) gift certificates include sales tax; (iii) actual sales information was available; and (iv) computer software was not accurate.
 6. Whether a use tax was due on several items in the Audit Report, including: (i) window cleaning – sales price included in price; (ii) sales tax was paid on equipment purchases; and (iii) purchases of some equipment and supplies are exempt as items were purchased for resale and sales tax collected.

Years: Sales and use tax periods beginning January 1, 2000 through and including September 30, 2004.

Amount: \$44,763.13

Status: **Awaiting Return and Answer from Commissioner.**

SCOTT HOWARD SCHULTZ v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7836
Taxpayer's Counsel
Pro se

Filed: April 24, 2006
DOR's Counsel

- Issue: 1. Whether taxpayer's receipt of \$35,000.00 in non-employee compensation from Aero Systems in 2002 was taxable income.

Years: Individual income tax 2002.

Amount: \$2,797.41

Status: **Awaiting Return and Answer from Commissioner.**

RICHARD F. ZALIGSON v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7837
Taxpayer's Counsel
Pro se

Filed: April 28, 2006
DOR's Counsel

- Issue: 1. Whether taxpayer is liable for individual income taxes for the periods 1991 through and including 1994 and 1997.

Years: Individual tax years 1991 through and including 1994 and 1997

Amount: \$23,273.46

Status: **Awaiting Return and Answer from Commissioner.**

SHARI A. HASTAD v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7838
Taxpayer's Counsel
Joseph F. Ferguson

Filed: May 2, 2006
DOR's Counsel

- Issue: 1. Whether Shari A. Hastad is personally liable for the taxes owed by C. Annie S Inc. for the tax periods June 2005, August 2005, and September 2005.
2. Whether taxpayer is personally liable when she was a minority shareholder, did not handle the day to day operations of the business, and did not perform any bookkeeping functions, and did not actively manage the restaurant.

Years: Sales tax and withholding tax for the periods ending June 2005, August 2005, and September 2005 Amount: \$23,583.62

Status: **Awaiting Return and Answer from Commissioner.**

LEE ALAN HAAKENSON v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7839
Taxpayer's Counsel
Pro se

Filed: May 2, 2006
DOR's Counsel

- Issue: 1. Whether taxpayer is liable for withholding tax for the periods within January 1, 2000 through and including September 30, 2003 for Press Any Key Inc.
2. Whether taxpayer had legal and/or actual control of check signing, hiring and firing of employees, the corporation's financial affairs, and the signature on checks, tax returns, etc.
3. Whether the amount of liability has been correctly computed.

Years: Withholding tax for January 1, 2000 through September 30, 2003 Amount: \$95,424.93

Status: **Awaiting Return and Answer from Commissioner.**

DOUGLAS A. HANSON v. COMMISSIONER OF REVENUE

Minnesota Tax Court Docket No. 7840
Taxpayer's Counsel

Filed: May 2, 2006
DOR's Counsel

- Issue: 1. Whether taxpayer is liable for personal income taxes for the tax periods beginning 1997 through and including 2003.

Years: Individual income tax returns for 1997 through and including 2003. Amount: \$246,716.51

Status: **Awaiting Return and Answer from Commissioner.**

The Costs of Limited Tax Education

By Ann Westerlund, *Mid-Minnesota Legal Assistance Tax Project*

Preparation of individual income tax returns is a task few taxpayers look forward to. However, for low income families, tax refunds can make up a significant percentage of their annual income. As part of the welfare-to-work programs of the mid-1990's, Congress greatly increased the maximum Earned Income Credit available to families. This increase coincided with the expansion of electronic filing and filing software availability. Electronic filing software has been used as an excuse by tax preparers to avoid taking classes on tax law changes. The theory is that as long as the software is current, the preparer does not need any education. Minnesota does not require paid tax preparers to obtain any education. Unfortunately for immigrants and low income taxpayers, the preparers most adverse to education have chosen to locate their businesses in immigrant and low income neighborhoods.

Recent immigrants to the United States may not have encountered an income tax system before. For instance, refugees from Somalia are fleeing a country that has not had a centralized government for 15 years and even when there was a government, only high-income families and businesses paid income tax. Non-English speaking immigrants are completely dependent upon their tax preparer to properly prepare their income tax returns. The Internal Revenue Service (IRS) offers information solely in English and Spanish despite the hundreds of languages spoken by taxpayers. Many small businesses have learned how to take advantage of this dependence.

Refund Anticipation Loans (RAL), which are short term loans repaid by a taxpayer's income tax refund, receive a lot of attention from the media. However, in Minnesota, tax preparers have developed a more lucrative system of processing refunds. The tax preparer writes his or her own personal bank account number as the direct deposit account on the taxpayer's income tax return. When the refund is received by the tax preparer, the preparer then writes a check to the taxpayer for the income tax refund, minus whatever fees the preparer chooses to charge. The taxpayer is never told the size of the fee that was deducted. It is not a loan. Several have questioned whether or not it is legal; however, it continues to occur. Tax preparers have an incentive to claim credits that the taxpayer does not qualify for because the credits increase the amount of money the preparer can deduct for fees.

Untrained tax preparers are costly, both to the government and the taxpayers. In April 2005, Yahye Shakal was indicted on 43 felony counts of tax fraud. For tax year 2004, Mr. Shakal claimed \$1.9 million in erroneous fuel tax credits. Many of the taxpayers involved are insolvent and may never be able to pay back the full amount of the refunds issued.

For the taxpayers, there is the obvious problem of paying the money back after the IRS investigates the tax preparer by auditing and assessing additional tax. For the immigrant taxpayer, there is the additional step of proving that your tax problems should not affect your ability to sponsor family members living in refugee camps, or your moral character assessment as part of the naturalization process.

To increase the tax information available to low income and immigrant taxpayers, organizations such as the Mid-Minnesota Legal Assistance Tax Project provide education to communities across the state of Minnesota. Initiatives have included statewide trainings for service providers, taxpayer education clinics, fact sheets available in twelve languages, and continued one-on-one counseling of clients. The University of Minnesota Law School Tax Clinic also reaches out to immigrant communities through education and representation.

With only two organizations covering the entire state, many immigrants will not get the education or representation they need. Several volunteer programs have been proposed to encourage attorneys with tax representation experience to provide services to these communities on a pro bono basis.

Low income tax clients present unique issues to the legal professionals who assist them. Tax issues, by nature, are complicated matters that may take years to completely resolve. Add the fact that many immigrants do not speak English and now, understandably, distrust the tax system and tax matters are complicated further. Explaining to a taxpayer raising a family on \$15,000 per year that they owe thousands of dollars to the IRS even though their tax preparer took most of the refund can be heartbreaking. Explaining that they must prove that their biological children are in fact, their children, through an interpreter into a language that does not have words for "qualifying child" or "financially dependent" can be frustrating.

For many reasons, immigrants prefer and have greater confidence in the information they receive from their own community. Educating immigrant tax preparers is the key to reducing fraud and preparation problems in Minnesota. Yet, few if any educational opportunities exist for hundreds of limited English speaking tax preparers. The cycle of untrained preparers costing federal and state governments millions of dollars that will not be collected from individual taxpayers will continue until a system is in place to train preparers fluent in the languages of recent immigrants.

Should Minnesota Step up to the BAT?

Replacing the Minnesota Corporate Franchise Tax with a Business Activities Tax

By Laura Kalambokidis, Associate Professor of Applied Economics, University of Minnesota

Faced with an eroding state corporate tax base, Minnesota policymakers have begun considering alternatives to taxing corporations on the basis of income. One alternative is a consumption-type Business Activities Tax (BAT), a form of value-added tax that would be levied on all firms, regardless of organizational form. In October 2005, the Minnesota Department of Revenue released a study, commissioned by the Legislative Coordinating Commission, that analyzes the effects of a revenue-neutral replacement of the current Minnesota Corporate Franchise Tax (CFT) and minimum fee with a BAT. This article summarizes some of the reasons for considering a BAT, some of the concerns about it, and the finding of the 2005 study.

The BAT is a tax on the value-added of all firms, regardless of organizational form. The base of the BAT is equivalently equal to (1) the sum of the payments to factors of production (labor and capital) and (2) the difference between a firm's sales and its purchases from other businesses. A "consumption-type" BAT allows full expensing for purchases of depreciable capital assets, and disallows depreciation allowances. The legislation mandating the BAT Study specified that the BAT for multi-state firms would be apportioned according to the firm's share of total sales in Minnesota, but the study also considered the impact of a three-factor apportionment scheme.

At least two state business taxes—the Michigan Single Business Tax (SBT) and New Hampshire Business Enterprise Tax (BET)—were conceived as forms of value-added taxes, but have been amended over the years. The BAT study, in contrast, simulates a very broad-based, "pure" version of a BAT, and diverges from this model only to include a small business exemption. Therefore, the simulated tax, while it is related to the SBT and BET, does not directly mimic either of them.

Several reasons are typically cited for considering a state BAT, but each has its counter-arguments. First, because the tax is levied on all firms, regardless of organizational form, it is neutral with regard to the choice of entity type. On the other hand, replacing a corporation tax with a tax on all businesses can be seen as unfair to non-corporate—especially small—businesses. Second, because payments to labor are not deductible under a BAT, labor compensation makes up a significant portion of the BAT base. The result is that BAT revenues should be relatively more stable than corporate income tax revenues. This advantage has a downside, however: critics view the BAT as placing an unfair burden on labor-intensive businesses. This criticism gained traction in the debates about the Michigan SBT. Third, the potentially broader nexus rules for a BAT—on all firms doing business in the state—is seen as an answer to the shrinking state corporate income tax base. But that advantage is threatened by Congressional efforts to restrict the nexus of state BATs. A final objection to moving away from an income base is that under a BAT, some businesses would have to pay tax in years that they have no income.

The basis of the 2005 study was a database of about 832,000 business tax returns constructed under the assumption that all firms doing business in Minnesota would have nexus for the Minnesota BAT. Therefore, the database includes 135,000 records for firms that had nexus for a Minnesota business tax during tax year 1999, the most recent year of federal tax data available at the time the study was begun. These companies

include C-corporations that were liable for the Minnesota Corporate Franchise Tax (CFT) and filed a Minnesota Form M-4; S-corporations that were liable for the S-corp minimum fee and filed a Minnesota Form M-8; and partnerships that were liable for the partnership minimum fee and filed a Minnesota Form M-3. The database also includes Minnesota individual income tax filers who reported business income (from a sole proprietorship, farm, or rental property) on their federal tax returns. Treating each Schedule C, E, or F as a separate taxpaying entity under the BAT added 675,000 records to the database.

Companies that do not have nexus for any of the taxes described above would still have nexus for the BAT if they sell goods or services in Minnesota or if they have employees in the state. In order to capture these businesses, the database included 22,000 entities that either paid state sales taxes in 1999 or withheld Minnesota income taxes for their employees in 1999.

Two classes of businesses that could have nexus for the BAT may be missing from the database: (1) firms protected from the state corporate income tax by Public Law 86-272 and (2) firms that sell into Minnesota through mail order or e-commerce, but are not registered for the state sales tax. However, the study may have captured the firms in the first group by including businesses that are registered for taxes other than the CFT, S-corp tax, and partnership tax. In particular, Public Law 86-272 firms that have a sales force in Minnesota must withhold Minnesota income taxes for their employees, and therefore would appear in the database.

The study takes several steps to estimate the impact of replacing the CFT with the BAT, including imputing missing variables to the tax records and simulating BAT liability for each firm in the database. The revenue-neutral BAT rate is simply the 1999 CFT and minimum fee liability divided by the aggregate simulated BAT base. The study reports that replacing 1999 corporate franchise tax and minimum fee revenues with a broad-based BAT on all firms doing business in Minnesota would have required a BAT rate of 0.71 percent. Note that the 0.71 percent rate is revenue-neutral only for 1999. The revenue-neutral rate in other years would differ from 0.71 percent because of changes in both the numerator (CFT receipts) and changes in the denominator (BAT base) in those years.

For C-corps filing a CFT return (Minnesota Form M-4), BAT liability calculated at the revenue-neutral rate is less than CFT liability, because under the BAT, the tax is shared with non-corporate businesses. This leads to an overall tax cut for M-4 filers of \$392 million. The study also reports that replacing the CFT with a BAT that is revenue-neutral for M-4 filers only would require a rate on those taxpayers of 1.58%.

Allowing each taxpayer, including each member of a unitary group, to exempt the first \$100,000 of its BAT base is estimated to raise the required revenue-neutral BAT rate to 0.86%. Under the exemption, 590,000 out of 832,000 total businesses (66,000 of which had liability for CFT or minimum fee in 1999) would be exempt from the BAT. Ninety-two percent of the exempt firms are Schedule C, E, and F filers (farm and nonfarm proprietors and rent-earners). At this level of exemption, 134,000 proprietors (Schedule C, E, or F filers) would pay BAT.

As explained above, the study database includes business entities that filed tax returns for tax year 1999, because that was the most recent year of federal tax data available at the time the study began. Therefore, the study reports BAT liabilities for tax year 1999, not for any particular calendar or fiscal year. To make the results more useful for policymakers, the study forecasts BAT liabilities for subsequent years and converts the liabilities into calendar year and fiscal year receipts. The study concludes that the 0.71%, broad-based BAT with no exemptions would yield approximately one billion dollars in both calendar year and fiscal year 2009. Viewed another way, a revenue-neutral replacement of

the CFT with a BAT in a future year could be achieved with a lower rate than 0.71%.

In the next legislative session, a general discussion about state business tax reform may include serious consideration of the BAT. Legislators may consult the BAT study, and may pursue additional questions. For example, what would be the effect of a different or larger small business exemption? Should alternative apportionment schemes be considered? And how will the forces that are threatening the corporate income tax base affect the BAT?

Minnesota State Bar Association 2005–2006 Tax Section Council and Officers

Bruce A. Ackerman
Faegre & Benson LLP
Suite 2200
90 S. Seventh St,
Minneapolis, MN 55402-3901
(612) 766-8503
backerman@faegre.com

Yuri Berndt, Treasurer
Moss & Barnett
4800 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402-4129
(612) 347-0267
berndty@moss-barnett.com

Donald J. Brown, Chair
Cargill, Inc.
P.O. Box 5626
Minneapolis, MN 55440-5626
(952) 742-6780
don_j_brown@cargill.com

Gina B. DeConcini
Deloitte Tax LLP
120 S. Sixth Street
400 One Financial Plaza
Minneapolis, MN 55402
(612) 397-4421
gdeconcini@deloitte.com

Peter Fuchsteiner
Gray Plant Mooty
1010 West St. Germain, Suite 600
St. Cloud, MN 56301
(320) 202-5314
peter.fuchsteiner@gpmlaw.com

Jerome A. Geis
Briggs and Morgan PA
332 Minnesota St. #W2200
Saint Paul, MN 55101-1396
(651) 223-6409
jgeis@briggs.com

William D. Klein
Gray Plant Mooty
500 IDS Center
80 South Eighth Street
Minneapolis, Minnesota 55402
(612) 632-3232
william.klein@gpmlaw.com

Paul J. Linstroth
Leonard Street & Deinard
Suite 2300
150 S. Fifth Street
Minneapolis, MN 55402
(612) 335-1431
pj11431@leonard.com

Tom Muck
Fredrikson & Byron, P.A.
200 S. 6th Street, Suite 4000
Minneapolis, MN 55402-1403
(612) 492-7045
tmuck@fredlaw.com

Jon L. Peterson, Vice Chair
Winthrop & Weinstine
Suite 3500
225 South Sixth Street
Minneapolis, MN 55402
(612) 604-6736
jpeterson@winthrop.com

Robert J. Stuart, *Secretary*
Fredrikson & Byron, P.A.
200 S. 6th Street, Suite 4000
Minneapolis, MN 55402-1403
(612) 492-7317
rstuart@fredlaw.com

Heather J. Broneak
Larson Allen Weishair & Co., LLP
220 S. Sixth Street, Suite 300
Minneapolis, MN 55402-1436
(612) 376-4648
hbroneak@larsonallen.com

Tax Section News

Daniel N. Kidney, Co-Editor

Heather J. Broneak, Co-Editor

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Comments, articles and letters to the editor should be mailed to:

Daniel N. Kidney, *Co-Editor*
Pricewaterhouse Coopers LLP
225 South Sixth Street, Suite 1400
Minneapolis, MN 55402-4654
(612) 596-4774
daniel.n.kidney@us.pwc.com

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