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# Capitol Link

## Governor Releases Budget Proposal

Minnesota Governor Mark Dayton released his proposed budget last week, proposing to increase spending from \$41.5 billion in fiscal years (FY) 2016-2017 to \$45.8 billion in FY 2018-2019. Republican legislative leaders were less than excited about a nearly 10 percent increase in spending. Dayton's cabinet members are now presenting details of the proposal to legislative committees.

The next big event will be receiving the February state budget forecast on which the next biennial budget will be based. The forecast last November projected a \$1.4 billion surplus, in addition to over \$2 billion in reserves. Keys to the forecast outcome will be what assumptions are used when creating the forecast and how President Donald Trump's economic views are perceived. In mid-January, four regional bank presidents agreed in principle that the policies of President Trump are likely to increase economic growth. On the other hand, there are those who express concerns about possible tariffs and their impact on the economy. If that's an assumption used by those creating Minnesota's budget forecast, the projected surplus may increase.

## Governor Proposes Big Changes for Commerce Banking Division

The Governor's budget proposes significant changes for the Minnesota Department of Commerce's Financial Institutions Division, some of which ICBM members have expected for some time. Commissioner Michael Rothman presented those proposals to members of the Senate Commerce Committee on Wednesday.

The Commissioner stated that one of the issues driving the recommendations affecting state-chartered banks includes a large expansion of non-depository institutions near the end of the last recession. The dramatic growth required some banking staff to be re-assigned to help regulate these institutions, worsening a pre-existing shortage of staff on the banking side of the Department. Second, members are well aware that the average age of staff in the banking area is near or at retirement age. This is made worse because many younger bank examiners are leaving for higher paying jobs with federal bank regulators or banks. ICBM members have been aware of this for some time. Commissioner Rothman said this has left the Department of Commerce with fewer experienced examiners, a higher percentage of entry-level examiners, and the end result is the quality of

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examinations has gone down. The commissioner described the banking area as severely under-staffed. So much so, that if this issue isn't resolved soon, "the division's ability to maintain national accreditation is threatened."

In response, the Governor approved the Department's recommendations and included those in his budget. One of the measures involves moving the Financial Institutions division from the state's general fund to a special revenue fund to give the department more budgeting flexibility.

Another proposal is to add 10 full-time workers for the purpose of regulating banks, non-depository institutions, and credit unions. Third, raising salaries for examiners so they are closer to market wages in the hope more of the younger examiners will stay with the department, thereby making staffing more stable over time and thus increase the quality of examinations. A fourth proposal would increase fees on non-depository institutions. While a portion of the additional costs would be paid by state-chartered banks, these costs would only fund direct bank regulation expenses. The proposal would not change the way banks are assessed or how examination fees are charged. It relies on the same mechanisms in place currently.

At this point, it appears this is a positive proposal for ICBM's members and customers, because it takes steps to preserve Minnesota's state-chartered banks and does so with little cost to members. More details on the funding need to be understood before a final position can be taken. One thing that is very clear is that losing accreditation would be costly and cause the loss of personal service Department of Commerce staff now provide to many ICBM members.

### Update on ICBM's Legislative Priorities

#### **Pass-Through Tax-Relief**

House File (HF) 328, authored by Rep. Sarah Anderson, R-Plymouth, was heard Wednesday, January 25 in the House Tax Committee. Its companion bill was introduced February 12 and is authored by Sen. Paul Anderson, R-Plymouth. ICBM testified in support of the bill at the House Tax Committee. Because other good points had already been made, ICBM primarily emphasized the concept of "shadow income," or business income owners pay tax on, even though that income primarily goes back into the business, not owners' pockets. Thus, affected businesses are taxed on income they don't get.

HF 328 limits the maximum individual income tax rate on active trade or business income (ex. of a sole proprietor, partner, or shareholder of an S corporation) to 7.85 percent, rather than the 9.85 percent rate of the fourth tier income, such as wages, interest, dividends, and passive business income would still be subject to the fourth tier if the total income reached the threshold. In short, the top tax rate on active trade or business income would go back to 7.85 percent as it was prior to when the 2013 DFL-controlled Legislature and Governor raised income taxes by creating the fourth tier and a tax rate of 9.85 percent.

to members only.

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ICBM introduced legislation in 2014 proposing that business income be exempt if it was reinvested in the business. If it wasn't, it would be added to personal income and taxed as it is today. That was the first bill proposing tax relief for independent pass-through businesses. Today, the Minnesota Chapter of the National Federation of Businesses and the Minnesota Chamber of Commerce both have tax relief measures for pass-through businesses amongst their top priorities.

### **Reduce or Repeal Minnesota's Estate Tax**

Three bills proposing to reduce or repeal Minnesota's estate tax were heard January 12 in the House Tax Committee. Two companions of those bills, Senate File (SF) 83 and SF 8, were heard in the Senate Tax Committee on January 25. ICBM testified in support of all three proposals in both committees.

### **Increase Exclusion**

HF 77 is authored by Rep. Peter Fischer, DFL-Maplewood, and its companion, SF 8 is authored by Sen. Chuck Wiger, DFL-Maplewood. They propose to increase the state's exclusion amount in 2017 from \$1.8 million to \$5 million and establish a 16 percent flat tax on the value of an estate above the exclusion amount.

### **Conform**

Also heard was HF 18, authored by Rep. Jenifer Loon, R-Eden Prairie. HF 18 proposes conforming to federal estate tax policy. This would increase the state's 2017 exclusion from \$1.8 million to \$5.4 million in 2017 and automatically adjusts for inflation in the future. The companion bill is SF 354 and is authored by Sen. Jeremy Miller, R-Winona. This bill has yet to be heard.

### **Repeal**

Finally, HF 85, authored by Rep. Joe McDonald, R-Delano, was heard January 12 in the House Tax Committee. This bill proposes to repeal Minnesota's estate tax as most other states have done since 2001, when Congress stopped giving a credit against the federal estate tax for taxes paid at the state level. The Senate companion bill is authored by Sen. Bruce Anderson, R-Buffalo. This bill was also heard in the Senate Tax Committee January 25.

### **Residency (Domicile) Bill; HF 182, authored by Rep. Greg Davids, R-Preston**

This bill modifies the definition of a resident for purposes of income and estate taxes so that the location of an individual's lawyer, certified public accountant, or financial adviser cannot be considered by the state courts or the Department of Revenue for income or estate tax purposes. In addition, the financial institution where an individual opens or maintains an account cannot be considered under HF 182.

HF 210, authored by Rep. Jerry Hertaus, R-Greenfield, takes a different approach by proposing that the definition of resident be modified to provide that an individual is not domiciled in Minnesota if the person files an affidavit with the Minnesota Department of Revenue, stating that he or she is domiciled in another state or country. The affidavit would be conclusive evidence. The affidavit must

be filed before the close of the calendar year to which it first applies and must be made in the form the state prescribes. It remains in effect until revoked.

Furthermore, HF 210 modifies the state's physical presence test for determining residency. It proposes that days do not count as Minnesota days (for purposes of the 183-day minimum), unless the taxpayer was in the state for nearly an entire day, including an overnight stay. Under present law, any presence in the state qualifies and is counted toward 183 days, unless the individual is in transit through the state (ex. changing planes). The bill also provides that presence in Minnesota for the primary purpose of receiving medical treatment (by the taxpayer, spouse, child, or parent) does not qualify as a Minnesota day. The companion bill, SF 102, is authored by Sen. David Osmeck, R-Mound, and has yet to be heard.

### **Background on Estate Tax**

Being treated as a resident subjects the taxpayer's entire income, (regardless of the type or the location it's derived from) to Minnesota income taxes (a credit applies to offset tax imposed by another state on that income.). By contrast, a nonresident is subject to tax only on Minnesota-source income (ex. income from work performed in Minnesota or investment income from tangible property or a business located in Minnesota).

### **Reduce or Eliminate the "Extra" Business Property Tax**

Minnesota is the only state in the country with a property tax just for businesses. The state's general levy is an extra tax on all business property. The tax is based on the property value of a business and adjusts upward automatically for inflation. Today, it equals about 33 percent of a business' total property tax bill.

ICBM is working to reduce this tax and repeal the inflator. The long-term goal is to repeal it completely. This tax was originally created to fully fund K-12 education. After a few years, legislators re-directed the tax revenue to the state's general fund to be used for any purpose. This is one more tax that makes Minnesota businesses less competitive and accounts in part for Minnesota's high commercial property taxes. According to the Minnesota Chamber of Commerce, Minnesota businesses are subject to the second highest property tax in the nation, and our metro businesses have the sixth highest.

ICBM encourages members to share their support for these issues with their Minnesota legislators. When you do, put a face on the issues above. I'm sure all of you know people who have experienced the issues listed above. Real stories of real people get the message across better than anything else.

In the meantime, ICBM is advocating for you at the State Capitol on these and other issues.

## We want to hear from you!

Do you know of any banking news happening in your region? Let us know. Email Joel Runck at [jrunck@icbm.org](mailto:jrunck@icbm.org) or call 651-789-3988.

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