MINNESOTA CODE OF AGENCY RULES

RULES OF THE DEPARTMENT OF REVENUE

1982 Reprint

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DEPARTMENT OF REVENUE

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13 MCAR S 1.6101	Practice of attorneys, accountants, agents, and preparers before the Department of Revenue.
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Chapter One: Valuation and Assessment of Electric, Gas Distribution, and Pipeline Companies (Utility Companies)

AR000745

13 MCAR S 1.0001 Introduction. On October 19, 1973, the Minnesota Supreme Court in Independent School District No. 99, et al. v. Commissioner of Taxation, 297 Minn. 378, ruled that in estimating the market value of utility properties for ad valorem tax purposes, the assessing authorities must consider every element and factor affecting market value. The assessment formula used to value operating utility property since 1962, based solely on the original cost less limited depreciation and commonly known as the "Hatfield Formula," was thus invalidated as a rule of general application.

These rules are promulgated to fill that void and reflect the manner in which the value of utility property will be estimated by utilizing data relating to the cost of the property and the earnings of the company owning or utilizing the property.

Since the commissioner of revenue is by statute the assessor of some of the utility property in the state of Minnesota and has supervisory powers over all assessments of property, and may raise or lower values pursuant to Minnesota Statutes, section 270.11, he will estimate the valuation of the entire system of a utility company operating within the state. The entire system will be valued as a unit instead of valuing the component parts, and the resulting valuation will be "allocated" or assigned to each state in which the utility company operates. Finally, by the process of apportionment, the portion allocated to Minnesota will be distributed to the various taxing districts within the state. Most of the data used in the valuation, allocation, and apportionment process will be drawn from reports submitted to the Department of Revenue by the utility companies. These reports will include Minnesota Department of Revenue Annual Utility Reports (UTL Forms), Annual Reports to the Federal Energy Regulatory Commission and Annual Reports to the Interstate Commerce Commission. Periodic examinations of the supporting data for these reports will be made by the Department of Revenue.

The methods, procedures, indicators of value, capitalization rates, weighting percents, and allocation factors will be used as described in 13 MCAR SS 1.0003-1.0006 for 1982 and subsequent years, or until, in the opinion of the commissioner of revenue, different conditions justify a change.

As in all property valuations the commissioner of revenue reserves the right to exercise his judgment whenever the circumstances of a valuation estimate dictate the need for it.

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ARC01457

13 MCAR S 1.0002 Definitions. As used in this chapter, the following words, terms and phrases shall have the meanings given to them by this rule, except where the context clearly indicates a different meaning.

A. Allocation. "Allocation" means the process of dividing the unit value of a utility company among the states in which the utility operates.

B. Apportionment. "Apportionment" means the process of distributing that portion of the utility company's unit value which has been allocated to Minnesota to the various taxing districts in which the utility company operates.

C. Book depreciation. "Book depreciation" means the depreciation shown by a utility company on its corporate books, and allowed the company by various regulatory agencies.

D. Capitalization rate. "Capitalization rate" means the relationship of income to capital investment or value, expressed as a percentage.

E. Electric company. "Electric company" means any company engaged in the generation, transmission, or distribution of electric power, excluding cooperatives and municipal corporations.

F. Gas distribution company. "Gas distribution company" means any company engaged in the distribution of natural or synthetic gas, excluding the cooperatives and municipal corporations.

G. Installed capacity. "Installed capacity" means the number of kilowatts a power plant is capable of producing as shown by the nameplates affixed to the generators by the manufacturer.

H. Integrated company. "Integrated company" means any company engaged in two or more utility operations within Minnesota, such as electric distribution and gas distribution, within the framework of one corporate structure.

I. Major generating plant. "Major generating plant" means any steam-electric power plant capable of generating 25,000 KW (kilowatts) or more; or any hydro-electric, internal combustion, or gas turbine power plant capable of generating 10,000 KW or more.

J. Net operating earnings. "Net operating earnings" means earnings from the system plant of the utility after the deduction of operating expenses, depreciation, and taxes, but before any deduction for interest.

K. Non-formula assessed property. "Non-formula assessed property" means property of a utility which is valued by the

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local or county assessor rather than by the Commissioner of Revenue.

L. Operating property. "Operating property" means any property, owned or leased, except land that is directly associated with the generation, transmission, or distribution of electricity, natural gas, gasoline, petroleum products, or crude oil. Examples of operating property include, but are not limited to, substations, transmission and distribution lines, generating plants, and pipelines. Land, garages, warehouses, office buildings, pole yards, radio communication towers, and parking lots are examples of non-operating property.

M. Pipeline company. "Pipeline company" means any company engaged in the transmission of natural gas, gasoline, petroleum products, or crude oil via a fixed line of pipes.

N. System plant. "System plant" means the total tangible property, real and personal, of a company which is used in its utility operations in all states in which it operates.

O. Throughput. "Throughput" means the amount of product measured in barrels, gallons, or cubic feet which passes through a pipeline.

P. Unit value. "Unit value" means the value of the system plant of a utility company taken as a whole without any regard to the value of its component parts.

Q. Weighted pipe line miles. "Weighted pipeline miles" means the product obtained by multiplying the number of miles of each size of a pipeline by the diameter in inches of each size. Example: a 6 mile pipeline 3 miles of which is 10 inches in diameter and 3 miles of which is 30 inches in diameter would have a weighted miles product of 120.

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13 MCAR S 1.0003 Valuation.

A. General. Because of the unique character of public utility companies, such as being subject to stringent government regulations over operations and earnings, the traditional approaches to valuation estimates of property (cost, capitalized income and market) must be modified when utility property is valued. Consequently, for the 1982 and subsequent assessment years, until economic and technological factors dictate a change, the value of utility company property will be estimated in the manner provided in this chapter.

B. Market approach. Market value implies a price for which an entire public utility enterprise might reasonably change hands between willing and informed buyers and sellers. The term presupposes a market of normal activity, no urgency to buy or sell on the part of either the buyer or seller, and continued operation of the utility as a single entity. Public utility property is seldom transferred as a whole unit under these

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circumstances. Consequently, after consideration of this approach, it has been decided that valuation of utility properties by this approach is speculative and unreliable and will not be employed as a method of valuation for utility property at this time.

C. Cost approach. The cost factor to be considered in the utility valuation formula is the original cost less depreciation of the system plant, plus improvements to the system plant, plus the original cost of construction work in progress on the assessment date. The original cost of any leased operating property used by the utility must be reported to the commissioner in conjunction with the annual utility report. If the original cost of the leased operating property is not available, the commissioner shall make an estimate of the cost by capitalizing the lease payments. Depreciation will not be allowed on construction work in progress. Depreciation will be allowed as a deduction from cost in the amount allowed on the accounting records of the utility company, as such records are required to be maintained by the appropriate regulatory agency.

Depreciation, however, shall not exceed the prescribed percentage of cost: for electric companies, 19 percent; for gas distribution companies, 47.5 percent; and for pipeline companies, 47.5 percent.

A modification to the cost approach to value will be considered by the commissioner when valuing electric utility property. The original cost of an electric utility's major generating plants will be increased if the cost of the plant falls below a certain standard. The standard to be used will be a national average of the cost per kilowatt of installed capacity. The cost per kilowatt of installed capacity is the total construction cost of the generating plant divided by the number of kilowatts the plant is capable of producing. The national average to be used will be computed by totaling the construction costs, excluding the cost of land, for major generating plants within the 48 contiguous United States. The total cost of the plants will be divided by the total generating capacity of the same plants to arrive at an average cost per kilowatt of installed capacity. A separate average will be computed for each type of plant: gas turbine, hydro-electric, and steam-electric. The plants used in the calculation will exclude federally constructed multi-purpose projects, and nuclear electric generating plants.

The information used to compute the average will be drawn from the latest issues of the following United States Department of Energy publications: Hydro-Electric Plant Construction Cost and Annual Production Expenses; Steam-Electric Plant Construction Cost and Annual Production Expenses; and Gas Turbine Electric Plant Construction Cost and Annual Production Expenses. The plants which will be used in the computation of the national average will be those plants built during the most recent 15 years included in these publications.

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An example of this computation of the national average cost per kilowatt of installed capacity is as follows:

Steam-Electric Generating Plants

Plant Cost

Plant	Excluding Land	Plant Capacity
A	$ 14,000,000	100,000 kw
B	13,000,000	90,000 kw
C	17,000,000	110,000 kw
D	14,500,000	80,000 kw
E	18,000,000	120,000 kw
F	10,000,000	70,000 kw
G	19,000,000	130,000 kw
H	9,000,000	60,000 kw
I	20,000,000	140,000 kw
J	8,000,000	50,000 kw
	$142,500,000	950,000 kw

Total plant cost ($142,500,000) divided by total plant capacity (950,000 kw) equals $150 average cost per kilowatt of installed capacity.

The national average cost per kilowatt of installed capacity will be compared to the specific cost per kilowatt of installed capacity for each of the major generating plants owned by the utility being valued. If the national average cost per kilowatt is greater than the subject plant cost, the subject plant will have additional dollars incorporated into its cost in order to raise its cost per kilowatt to the national average. If the subject plant's cost per kilowatt equals or exceeds the national average, no cost will be added.

The following example illustrates this procedure:

XYZ Utility

Steam-Electric Generating Plants

1.	Plant	#1	#2
2.	Installed Capacity	100,000 kw	50,000 kw
3.	Year in Service	1970	1950
4.	Cost of Plant (Exclusive of Land)	$15,200,000	$5,000,000
5.	Specific Plant Cost per kw	$152	$100
6.	National Average Cost per kw	$150	$150
7.	Deficiency	none	$ 50
8.	Additional Cost (Line 7 x Line 2)	none	$2,500,000

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This additional cost to be added to the original cost of the specific plant will be reduced by an allowance for pollution control equipment and an allowance for obsolescence.

The allowance for pollution control equipment will be computed annually by totaling the construction costs, exclusive of land, of all major generating plants within Minnesota by type of plant. A total will also be made of the cost of the equipment in these plants which has been approved for tax exempt status in accordance with Minnesota Statutes, section 272.02, subdivision 1, clause (15). This total will also be computed by type of plant. The total of the approved pollution control equipment will be divided by the total construction cost, exclusive of land, of the plants in order to calculate a percentage. This percentage will be the ratio of dollars spent for pollution control equipment to total dollars spent to construct a specific type of power plant. This percentage will then be used to reduce the gross additional cost to be added to the cost of the specific generating plant. An example of this process is as follows:

Steam-Electric Plants Within Minnesota

Plant	Plant Cost Excluding Land	Cost of Approved Pollution Control Equipment
A	$15,200,000	$1,500,000
B	10,000,000	1,000,000
C	5,000,000	700,000
D	20,000,000	2,000,000
E	16,500,000	1,470,000
	$66,700,000	$6,670,000

Total cost of approved pollution control equipment ($6,670,000) divided by total plant cost ($66,700,000) equals 10 percent ratio of pollution control equipment expenditures to total expenditures for generating plant construction.

XYZ Utility

Steam-Electric Plant #2

1.	Additional Cost Due to Computation of Average Cost per kw of Installed Capacity	$2,500,000
2.	10% Allowance for Pollution Control Equipment	250,000
3.	Additional Cost to be Added after Adjustment for Pollution Control Equipment	2,250,000

The allowance for obsolescence which will be applied to the

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additional plant construction cost will be computed annually for hydro-electric and steam-electric generating plants. The information needed to compute the obsolescence factors will be drawn from the same publications that are used to compute the national average cost per kilowatt of installed capacity figure. Gas turbine plants will not have any obsolescence allowance applied to the additional cost added to the plants.

The obsolescence allowance for hydro-electric plants will be calculated through the use of a "plant factor." The plant factor is computed by dividing the number of kilowatt hours a generating plant actually produced in a year by the number of kilowatt hours the plant was capable of producing. The plant factor is normally expressed as a percentage. The mathematical expression of this factor is: net generation (kwh) divided by annual installed capacity (hours in a year X installed capacity (kw)). A standard plant factor will be computed for hydro-electric plants by averaging the plant factors of the ten plants with the highest plant factors in the 15 year study period. This standard will then be compared to an average of the most recent three years' plant factor of the subject plant. The amount the subject plant deviates from the standard is the amount of obsolescence which will be applied to the added cost.

An example of this obsolescence allowance computation is shown below.

Hydro-Electric Plants

Plant	Net Generation kwh (000)	Plant Capability kwh (000)	Plant Factor
A	400,150	755,000	53 %
B	300,040	577,000	52 %
C	250,000	480,000	52 %
D	600,000	1,250,000	48 %
E	896,000	1,600,000	56 %
F	700,000	1,400,000	50 %
G	507,000	975,000	52 %
H	450,000	1,000,000	45 %
I	376,000	800,000	47 %
J	810,000	1,800,000	45 %
		Average	50 %

XYZ Utility

Hydro-Electric Plant #4

Year	Net Generation kwh (000)	Plant Capability kwh (000)	Plant Factor
19XX	400,000	1,000,000	40 %
19XX	500,000	1,000,000	50 %
19XX	450,000	1,000,000	45 %
		Average	45 %

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Hydro-electric plant #4 plant factor (45 percent) divided by standard plant factor (50 percent) equals 90 percent. Therefore, hydro-electric plant #4 deviates from the standard by 10 percent, or is 10 percent obsolete.

The obsolescence allowance for steam-electric generating plants will be computed annually using two indicators. The first indicator will be the plant factor. The plant factor for steam-electric plants will be computed and applied in the same manner as the computation specified for hydro-electric plants. The only difference will be that the information used for the computation will be drawn from the latest Steam-Electric Plant Construction Cost and Annual Production Expenses publication rather than the Hydro-Electric Plant publication. Plant factors of the ten best steam-electric generating plants within the 15 year study period will be averaged. This average will be compared to the most recent three year average plant factor for the subject plant. The subject plant's deviation from the standard plant factor is the amount of indicated obsolescence.

The second indicator which will be used to compute an obsolescence allowance for steam-electric generating plants will be a thermal efficiency factor. The source of information for this computation will also be the latest issue of the United States Department of Energy's publication, Steam-Electric Plant Construction Cost and Annual Production Expenses. Thermal efficiency for a generating plant is measured by the number of British thermal units (B.T.U.) required to produce one kilowatt hour. This efficiency rating can be obtained by dividing the number of kilowatt hours produced by a generating plant by the number of B.T.U.'s needed to produce this power. The number of B.T.U.'s used can be obtained by multiplying the units of fuel burned by the generating plant - tons of coal, gallons of oil, or cubic feet of gas - by the average B.T.U. content of the fuel unit. The standard thermal efficiency factor will be computed by averaging the thermal efficiency factor of the ten most efficient steam-electric generating plants within the 15 year study period used to compute the average cost per kilowatt of installed capacity. This standard thermal efficiency factor will then be compared to the thermal efficiency factor of the subject plant. The amount the subject plant deviates from the standard is the amount of obsolescence indicated by this factor.

The two obsolescence figures for the subject plant as indicated by both the plant and thermal efficiency factors will then be averaged. This resulting average is the obsolescence allowance which will be applied to the cost added to the subject plant as a result of the average cost per kilowatt of installed capacity computation. In no instance shall the original cost of a generating plant be reduced by an allowance for obsolescence unless its cost is increased through the use of the average cost per kilowatt of installed capacity computation.

The following examples illustrate computation of the standard thermal efficiency factor; obsolescence indicated by the application of this factor to the subject plant; average

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obsolescence for steam-electric generating plants; and obsolescence allowance adjustment of the added cost due to the use of the average cost per kilowatt of installed capacity for the subject plant.

Steam-Electric Generating Plants

Plant	Net Generation kwh (Millions)	BTU's Used (Millions)	BTU's per kwh
A	2,000	18,400,000	9,200
B	6,000	53,400,000	8,900
C	8,000	72,000,000	9,000
D	5,000	45,500,000	9,100
E	3,000	26,400,000	8,800
F	1,000	9,000,000	9,000
G	4,000	36,600,000	9,150
H	9,000	80,550,000	8,950
I	7,000	61,950,000	8,850
J	5,000	45,250,000	9,050
		Average	9,000

XYZ Utility Company

Steam-Electric Plant #2

Net Generations kwh (Millions)	BTU's Used (Millions)	BTU's per kwh
2,000	21,600,000	10,800

Steam-electric plant #2 thermal efficiency factor (10,800 BTU's per kwh) divided by standard thermal efficiency factor (9,000 BTU's per kwh) equals 120 percent. Therefore, steam-electric plant #2 deviates from the standard by 20 percent or is 20 percent obsolete.

XYZ Utility Company

Steam-Electric Plant #2

1.	Obsolescence Indicated by Plant Factor	10%
2.	Obsolescence Indicated by Thermal Efficiency Factor	20%
3.	Obsolescence Allowance (Average of 1 and 2)	15%
4.	Additional Cost due to Computation of Average Cost per kw of Installed Capacity	$2,500,000
5.	15% Obsolescence Allowance	375,000
6.	Additional Cost to be Added after Adjustment for Obsolescence	2,125,000

The cost indicator of value computed in accordance with C. will be weighted for each type of utility company as follows: electric companies, 85 percent; gas distribution companies, 75

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percent; and pipeline companies, 75 percent.

The following example illustrates how the cost indicator of value would be computed for an electric company:

1.	Utility Plant (Cost)	$200,000,000
2.	Construction in Progress	5,500,000
3.	Additional Value From Average Cost per kw Computation	2,000,000
4.	Total Plant	207,500,000
5.	Non-Depreciable Plant (Land, Intangibles, C.W.I.P.)	17,500,000
6.	Depreciable Plant	190,000,000
7.	Depreciation (Maximum 19%)	36,100,000
8.	Total Cost Indicator of Value	171,400,000

Any company for which a modification is made under 13 MCAR S 1.0003 C. due to the average cost per kilowatt adjustment being made to original cost of a plant or plants located in Minnesota shall have an alternative cost indicator computation made without giving effect to the average cost per kilowatt adjustment of such plant or plants.

D. Income approach to valuation. The income indicator of value will be estimated by weighting the net operating earnings of the utility company for the most recent three years as follows: most recent year, 40 percent; previous year, 35 percent; and final year, 25 percent. After considering, as far as possible, all conditions that may exist in the future that may affect the present annual return, including risk, life expectancy of the property, and cost of money, the capitalization rates used to compute value for the assessment will be: electric companies, 8.75 percent; gas distribution companies, 9.0 percent; and pipeline companies, 9.25 percent. The income indicator of value computed in accordance with D. will be weighted for each class of utility company as follows: electric companies, 15 percent; gas distribution companies, 25 percent; and pipeline companies, 25 percent.

The following example illustrates how the income indicator of value would be computed for a pipeline company:

		1980	1981	1982
1.	Net Operating Income	$ 468,000	$ 385,700	$ 450,000
2.	Capitalized Income @ 9%	5,200,000	4,285,600	5,000,000
3.	Weighting Factor	25%	35%	40%
4.	Weighted Capitalized Income	1,300,000	1,500,000	2,000,000
5.	Total Income Indicator of Value			4,800,000

E. Unit value computation. The unit value of the utility company will be the total of the weighted indicators of value.

The following is an example of the computation of the unit

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value for a pipeline company:

1.	Cost Indicator of Value....	$5,000,000 x 75%	= $3,750,000
2.	Income Indicator of Value..	$4,800,000 x 25%	= $1,200,000
3.	Unit Value of Pipeline Company	100%	$4,950,000

Any company whose cost indicator was modified under 13 MCAR S 1.0003 C. to reflect the average cost per kilowatt adjustment of a plant or plants located in Minnesota shall have an alternative unit value computation made without giving effect to the modification in respect of such plant or plants.

F. Valuation of utility property of cooperatives and other non-common carrier or non-regulated utilities. Cooperative associations and other types of utilities which do not operate in the traditional profit making mode, are not common carriers, or are non-regulated, will have their utility property valued on the basis of historical cost only. Depreciation will be allowed as a deduction from the historical cost in increments of 2.5 percent per year, but the maximum depreciation allowed shall not exceed 25 percent of the cost of the utility operating property. Additions to existing utility property will be depreciated 2.5 percent per year until they reach the 25 percent maximum. Retirements of utility property will be deducted from the cost basis at the appropriate depreciation level of the retired property.

The following example illustrates this process for an electric cooperative association:

1.	Cost of Substation	$1,000,000
2.	Value 1st year @ 97.5%	975,000
3.	Value 2nd year @ 95%	950,000
4.	Value 3rd year @ 92.5%	925,000
5.	Value 4th year @ 90%	900,000
6.	Value 5th year @ 87.5%	875,000
7.	Value 6th year @ 85%	850,000
8.	Value 7th year @ 82.5%	825,000
9.	Value 8th year @ 80%	800,000
10.	Value 9th year @ 77.5%	775,000
11.	Value 10th year @ 75%	750,000
12.	Value 11th and succeeding years at 75%	750,000

G. Obsolescence allowances. The commissioner shall adjust the value calculated under 13 MCAR S 1.0003 through the use of an obsolescence allowance. This allowance is intended to be used in order to recognize the effect the curtailment or termination of a pipeline's source of supply may have on its value. This allowance must be applied for each year at the time the utility files its Minnesota Department of Revenue Annual Utility Report. The utility's eligibility for this allowance will be based on the relevant facts for the specific valuation year. The application of an obsolescence allowance in any previous year shall have no bearing on the use of the allowance for a subsequent year. In order for a pipeline or a gas distribution company to be eligible for this allowance it must

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meet certain criteria or standards listed below. It is mandatory that standards 1., 2., and 3. be met by the utility. It is highly desirable that standards 4. and 5. also be met.

1. The utility shall demonstrate that its source of supply for gas or oil will be terminated within the next ten years.

2. The utility shall be at, or above, the maximum depreciation allowance specified by C.

3. The utility shall have made application to the appropriate regulatory agency for increased depreciation allowances, and the application shall not have been denied or rejected.

4. The utility must not have made any major capital expenditures within the last three years.

5. The utility must not have sold any long term bonds or signed any long term notes within the last three years.

If the utility has made major capital expenditures or entered into long term debt obligations within the last three years, a satisfactory explanation of the rationale for these actions shall be made to the commissioner before an allowance for obsolescence will be granted.

The obsolescence allowances which may be applied to the utility's value will be calculated in the following manner:

Method 1. A five year average of the utility's annual throughput will be calculated. The throughput for the assessment year will be compared to this average and a percentage calculated. This percentage will be applied to the cost indicator of value calculated under C. in order to adjust the indicator for obsolescence. The adjusted cost indicator of value will be used in the calculation of the unit value under E. The following is an example of this procedure:

Year	Throughput in Barrels
1977	1,200,000
1978	1,300,000
1979	1,150,000
1980	1,100,000
1981	1,050,000
	5,800,000 Total
	1,160,000 Average Throughput

1.	1982 Throughput	1,000,000 Barrels
2.	Percent of 1982 Throughput to 5 Year Average Throughput	86%
3.	Cost Indicator of Value	$6,300,000
4.	Cost Indicator Adjusted for Obsolescence	5,418,000

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Method 2: The book depreciation shown on the books and accounts of the utility will be compared to the depreciation allowed by C. If the book depreciation exceeds the maximum depreciation allowance, 50 percent of the excess depreciation will be used in the calculation of the cost indicator of value. An example of this calculation is as follows:

1.	Book Depreciation	$6,000,000
2.	Maximum Allowable Depreciation	4,750,000
3.	Excess Depreciation	1,250,000
4.	50% of Excess Depreciation	625,000
5.	Utility Plant	11,000,000
6.	Construction Work in Progress	50,000
7.	Total Plant	11,050,000
8.	Non-Depreciable Plant (Land, CWIP)	1,050,000
9.	Depreciable Plant	10,000,000
10.	Depreciation (Maximum 47.5%)	4,750,000
11.	Obsolescence Allowance	625,000
12.	Cost Indicator of Value	5,675,000

Method 3. The income indicator of value computed in accordance with D. will be calculated by capitalizing the utility's three-year weighted net operating earnings for a specific term of years rather than into perpetuity. The term of years to be used will be the number of years remaining until the expected expiration of the utility's source of supply for product (oil, gas), or the number of years remaining until the utility's major assets (pipeline, pump stations, storage tanks, and similar assets) are fully depreciated, whichever is greater. An example of this capitalization process is as follows:

		1979	1980	1981
1.	Net Operating Earnings	$1,320,000	$1,000,000	$800,000
2.	Weighting	25%	35%	40%
3.	Weighted Net Operating Earnings	$330,000	$350,000	$320,000
4.	Total Weighted Net Operating Earnings		$1,000,000	
5.	Terms of years until major assets are fully depreciated			8
6.	Capitalization rate pursuant to 13 MCAR S 1.0003 D.			9%
7.	Capitalization rate converted to term of 8 years			18.0674%
8.	Capitalized Income/Income Indicator of Value			$5,534,831

The commissioner shall apply to the valuation process whichever of the three obsolescence methods is most appropriate in order to equitably recognize the effect of obsolescence on the utility's value.

H. Retirements. Utility operating property may be retired

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from the utility system while still in place if certain criteria are met.

1. The property must be physically disconnected from the utility system. In the case of electrical plants, the disconnection or dismantling of wires, cables, connectors, or transformers would constitute physical disconnection. In the case of pipelines, the disconnection of pipes, valves, or fittings would be evidence of physical disconnections.

2. An affidavit of retirement should be filed by the utility with the commissioner at least 30 days prior to the assessment date. This affidavit shall indicate the facility being retired and the date it was taken out of service.

The utility should make every effort to inform the commissioner of pending major retirements. The commissioner in turn shall notify the county assessor of impending major retirements as soon as this information becomes available to the department.

Utility property which is retired in place shall continue to be taxed for ad valorem purposes. However, its market value shall not be determined on the basis of its value as utility operating property.

If a utility should choose to temporarily retire a facility pending the development of an alternate fuel, greater demand, increased source of supply, or another valid reason, the cost of this facility must be transferred to the appropriate regulatory agency's account entitled "Held for Future Use." Standby facilities will not be considered to be temporarily retired unless their costs are carried in this account. Temporarily retired utility facilities will be valued taking into account a number of factors including age of the facility, type of facility, amount of maintenance and additional costs needed to restore the facility to operational status, length of retirement, and earning potential of the facility. In no instance shall a temporarily retired facility be valued lower than if the facility were considered non-operating utility property.

AR001451

13 MCAR S 1.0004 Allocation.

A. General. After the unit value of the utility property has been estimated, the portion of value which is attributable to Minnesota must be determined. This process of dividing the unit value of a utility company among the states in which the utility operates is called allocation. Each of the factors in the allocation formula is assigned a weighted percentage to denote the relative importance assigned to that factor. The resulting sum of the weighted factors multiplied by the unit value yields the valuation of the utility property which will, after the adjustments described in 13 MCAR S 1.0005, be subject to ad valorem tax in the state of Minnesota.

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The factors to be considered in making allocations of unit value to Minnesota for the utility companies and the weight assigned to each factor for each class are specified in this rule.

B. Electric companies. The original cost of the utility property located in Minnesota divided by the total original cost of the property in all states of operation is weighted at 90 percent. Gross revenue derived from operations in Minnesota divided by gross operations revenue from all states is weighted at ten percent.

The following example illustrates this formula, assuming a unit value of $20,000,000.

1. Minnesota Plant Cost.....$115,000,000
2. System Plant Cost..... 205,000,000

3. Minnesota Gross Revenue.....40,000,000
4. System Gross Revenue.....105,000,000

5.	Total Percentage Allocable to Minnesota.....	54.29%
6.	Unit Value of System Plant.....	$20,000,000
7.	Amount of Value Allocable to Minnesota....	10,858,000

If any modification has been made to the cost indicator under 13 MCAR S 1.0003 C. to reflect the average cost per kilowatt adjustment of a plant or plants located in Minnesota, an alternative computation of the Minnesota allocation shall be made without giving effect to the modification in respect of such plant or plants.

C. Gas distribution companies. The allocation of value of gas distribution companies shall be made considering the same factors as are used to determine the allocation of value of electric companies. The weight given to the original cost factor will be 75 percent, and gross revenue shall be weighted 25 percent.

D. Pipeline companies. In addition to the cost factor and the gross revenue factor, the factor of weighted pipeline miles shall be considered in allocating the value of pipeline companies. Weighted pipeline miles means the number of miles of pipeline multiplied by the diameter of the pipe, measured in inches. To illustrate, a pipeline 6 miles long has 3 miles of pipe with a diameter of 10 inches and 3 miles of pipe with a diameter of 30 inches. The weighted pipeline miles is 120.

3 miles x 10" diameter	=	30
3 miles x 30" diameter	=	90
Weighted pipeline miles	=	120

The following example illustrates the allocation of value

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of property of a pipeline company and the weights given to each factor:

1. Minnesota Plant Cost.....$13,500,000
2. System Plant Cost.....$39,300,000

3. Minnesota Gross Revenue....$2,980,000
4. System Gross Revenue.....$9,300,000

5. Minnesota Weighted Pipeline Miles.....9,500
6. System Weighted Pipeline Miles..27,100

7. Total Percentage Allocable to Minnesota..... 34.37%

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13 MCAR S 1.0005 Adjustments for non-formula assessed or exempt property.

A. After the Minnesota portion of the unit value of the utility company is determined, any property which is non-formula assessed or which is exempt from ad valorem tax, will be deducted from the Minnesota portion of the unit value. Only that qualifying property located within the state of Minnesota may be excluded.

B. The following properties will be valued by the local or county assessor and, therefore, the formula provided herein for the valuation of utility property will not be applicable for such property:

1. Land;

2. Non-operating property;

3. Rights of way.

C. The Minnesota portion of the unit value will be reduced by the original cost of land and rights of way. In the case of non-operating property, the deduction shall be original cost, less the rate of depreciation applicable in the valuation process pursuant to 13 MCAR S 1.0003.

D. A deduction from the Minnesota portion of the unit value shall also be made for property, real or personal, which is exempt from ad valorem tax. For instance, pollution control equipment for which an exemption has been granted is exempt. A deduction from the Minnesota portion of the unit value shall be made at original cost, less the applicable rate of depreciation used in the valuation process under 13 MCAR S 1.0003. The value of personal property, such as office machinery and vehicles,

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which is not taxed, shall also be excluded from the Minnesota portion of the unit value. The deduction shall be at original cost less the applicable rate of depreciation utilized in the valuation process.

The following example illustrates how these items are deducted from the Minnesota portion of the unit value.

1.	Minnesota Portion of Unit Value.....		$5,000,000
2.	Excludable Items - Nondepreciable		
	a. Land Assessed Locally.....		3,000
	b. Land Rights.....		2,000
3.	Excludable Items - Depreciable		
	a. General Plant Items.....	$10,000	
	b. Pollution Control Equipment.....	10,000	
	c. Gross Depreciable Items.....	20,000	
	d. Depreciated at 25%.....	5,000	
	e. Net Depreciable Excludable Items		15,000
4.	Total Excludable Items.....		20,000
5.	Minnesota Apportionable Value.....		4,980,000

If any modification has been made to the cost indicator under 13 MCAR S 1.0003 C. to reflect the average cost per kilowatt adjustment of a plant or plants located in Minnesota, an alternative computation of the Minnesota apportionable value shall be made without giving effect to the modification in respect of such plant or plants.

E. The utility company shall have the burden of proof to establish that the value of any property should be excluded from the Minnesota portion of the unit value. Accordingly, the utility company shall have the responsibility to submit, in the form required by the commissioner of revenue, such schedules of exempt or non-formula assessed property as he may require.

AR007457

13 MCAR S 1.0006 Apportionment.

A. After the unit valuation of the utility company has been allocated to the state of Minnesota and has been adjusted under 13 MCAR S 1.0005, the determined amount shall be apportioned or distributed to the taxing districts in Minnesota in which the company operates. This apportionment will be made by the commissioner of revenue on the basis of information submitted by the utility companies in annual reports filed with the commissioner.

If any modification has been made to the cost indicator under 13 MCAR S 1.0003 C. to reflect the average cost per kilowatt adjustment of a plant or plants located in Minnesota, the apportionment to the taxing districts made under 13 MCAR S 1.0006 C. shall be based upon the Minnesota apportionable value alternatively computed in 13 MCAR S 1.0005 D. without giving effect to the modification in respect of such plant or plants.

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B. The following information must be submitted for each taxing district:

1. The market value of the company's operating property by classification, as reflected in the last assessment, including the cost of leased taxable property.

2. The original cost of the company's operating property by classification, including the cost of leased taxable property.

3. The original cost of any new additions since the last assessment, including work in progress on the assessment date.

4. The market value of any retirements made after the last assessment, as reflected in that assessment.

5. The original cost of any retirements made after the last assessment.

6. Whenever a new taxing district is established, the information submitted by the utility companies for the taxing district must be submitted in the same form as enumerated in 1.-5. If the utility, because of administrative difficulty, is forced to make estimates of values and costs for property within new taxing districts, these estimates must be approved by the commissioner.

C. The total market value of each company's operating utility property in Minnesota shall be divided by the greater of:

1. The last market value of the company's operating utility property in each taxing district, plus original cost of new construction, reduced by the last market value of property retired since the last assessment.

2. The original cost of the company's operating utility property in each taxing district plus original cost of new construction reduced by the original cost of property retired since the last assessment multiplied by the percentage as specified below.

For the 1982 assessment year the original costs shall be multiplied by 77.5 percent.

For the 1983 assessment year the original costs shall be multiplied by 80 percent.

For the 1984 assessment year the original costs shall be multiplied by 82.5 percent.

For the 1985 assessment year the original costs shall be multiplied by 85 percent.

For the 1986 assessment year the original costs shall be multiplied by 87.5 percent.

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For the 1987 assessment year the original costs shall be multiplied by 90 percent.

For the 1988 assessment year the original costs shall be multiplied by 92.5 percent.

For the 1989 assessment year the original costs shall be multiplied by 95 percent.

For the 1990 assessment year the original costs shall be multiplied by 97 percent.

For the 1991 assessment year the original costs shall be multiplied by 100 percent.

All computations made under alternative 1. or 2. shall be made without giving effect to any modification to reflect the average cost per kilowatt adjustment made under 13 MCAR S 1.0003 C.

D. For this purpose, the last market value and the last assessment shall mean the latest assessment immediately prior to the current assessment. The portion of unit value to be assigned to each taxing district will be the resulting percentage multiplied by the Minnesota portion of the unit value, as adjusted pursuant to this rule.

E. After all other computations have been made under 13 MCAR S 1.0006, there shall be added to the value of each district in which there is located a plant or plants qualifying for the average cost per kilowatt adjustment under 13 MCAR S 1.0003 C. a share of the difference between the Minnesota apportionable value computed under 13 MCAR S 1.0005 with the adjustment, and without the adjustment in respect to plants located in Minnesota, in proportion to the amount of the adjustment made with respect to the property located in each such district.

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Ad Valorem Tax Rules
Chapter Two: Valuation and Assessment of Railroads

13 MCAR § 1.0021 General Procedures. Laws 1979, Chapter 303, Article VII (the so-called Omnibus Tax Bill) codified as Minn. Stat. § 270.80 et. seq. (1979 Supp.) eliminated the gross earnings tax on Minnesota railroads and replaced it with an ad valorem tax on all railroad operating property. The Article also charges the Commissioner of Revenue with the responsibility of developing rules, both temporary and permanent, which will implement the provisions of the law dealing with the ad valorem method of taxing railroads.

The first valuation of railroad operating property will be made for the assessment year 1979. No apportionment of value to the local taxing districts will be made until 1981 for ad valorem taxes payable in 1982.

The methods, procedures, indicators of value, capitalization rates, weighting percents, allocation factors and apportionment standards will be used as described in this chapter for 1979 and subsequent years.

13 MCAR § 1.0022 Definitions. As used in this chapter, the following words, terms and phrases shall have the meanings given to them by this rule. Some of the words, terms and phrases listed below are defined by statute but are included here for completeness.

A. "Allocation" means the process by which a fair and reasonable portion of each railroad's total unit value is assigned to Minnesota for purposes of taxation.

B. "Apportionment" means the process of distributing that portion of the railroad's unit value which has been allocated to Minnesota after deducting exempt and non-operating property to the various counties and taxing districts in which the railroad company operates.

C. "Book depreciation" means the depreciation shown by a railroad company on its corporate books, and allowed the company by the Interstate Commerce Commission.

D. "Capitalization rate" means an anticipated rate of return from an investment; a rate at which income is processed (capitalized) to indicate the probable capital value. This rate is usually expressed as a percentage.

E. "Exempt property" means property which is non-taxable for ad valorem tax purposes by statues. Examples of such property are approved pollution control equipment for which an exemption has been granted, and personal property otherwise exempt from taxation under Minn. Stat. Chapter 272.

F. "I.C.C." means the Interstate Commerce Commission, a Federal regulatory agency.

G. "Mainline Track" means all track reported to the I.C.C. by the respondent railroad as main line.

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H. "Non-Operating property" means all property owned by a railroad company which does not fall under the definition of operating property. Non-operating property shall include real property which is leased or rented or available for lease or rent to any person which is not a railroad company. Vacant land shall be presumed to be available for lease or rent if it has not been used as operating property for a period of one year preceding the valuation date. It shall also include land which is not necessary and integral to the performance of railroad transportation services and which is not used on a regular and continual basis in the performance of these services.

I. "Operating property" means all property owned or used on a regular and continual basis by a railroad company in the performance of railroad transportation services, including without limitation franchises, rights-of-way, bridges, trestles, shopes, docks, wharves, buildings and structures.

J. "Original Cost" means the amount paid for an asset as recorded on the railroad's books in accordance with ICC accounting rules and regulations.

K. "P.U.C." means the Minnesota Public Utilities Commission.

L. "Railroad Company" means any company which as a common carrier operates a railroad or a line or lines of railway situated within or partly within Minnesota.

M. "Structure" means all coal and ore wharves or docks, station houses, depots, shops, office buildings, and all other buildings with an original cost of over $10,000.

N. "System" means the total tangible property, real and personal, of a company taken as a whole without any regard to the value of its component parts.

P. "Weighting" means the confidence or reliability given to a factor or indicator. It is usually expressed as a portion of 100%.

13 MCAR § 1.0023 Reports Required.

A. The data used in the valuation, allocation and apportionment processes will be drawn from reports submitted to the Department of Revenue by the railroad companies. These reports are to be filed with the Commissioner on or before April 30 of each year and shall include:

1. The Minnesota Department of Revenue Annual Railroad Report.

2. Annual Report to the Interstate Commerce Commission.

3. Annual Report to the Minnesota Public Utilities Commission.

4. Annual Stockholders Report.

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5. Other commonly accepted sources of railroad income, expense, capitalization and debt and stock values such as Standard & Poor's Stock Guide, Standard & Poor's Statistical Service, Moody's Transportation Manual, and Transportation Statistics in the United States compiled by the Interstate Commerce Commission.

B. Periodic examination of the supporting data for these reports will be made by the Department of Revenue. The Commissioner shall upon written application from the railroad, extend the filing date 30 days.

C. In the event any railroad company shall fail to file the required reports, the Commissioner shall make a valuation according to his best judgement based on available information.

D. Other sources of pertinent information may be consulted only when necessary to make the valuation, allocation and apportionment requried by §§ 1.0021 to 1.0026. Said sources will, when applicable, be used uniformly and will be commonly accepted sources of data for which they are consulted. Questions unique to the valuation of a particular railroad may be resolved by consulting the books and records of the particular railroad involved.

13 MCAR § 1.0024 Valuation.

A. General: The Minnesota Legislature has specified that railroads must be valued using the unit basis of estimating value. The approaches to value which will be used in determining the estimated unit value of railroad operating property are cost, capitalized income, and stock and debt except as provided for in 13 MCAR § 1.0024 D. and F. It is the decision of the Commissioner of Revenue that for 1979 and subsequent years the value of railroad property will be determined using these three approaches to value, where applicable, in the manner provided for in this section.

B. Cost approach to valuation. The cost factor that will be considered in the railroad valuation method is the original cost of the railroad system, plus the original cost of construction work in progress on the assessment date. The railroad system shall be considered to be made up of the following I.C.C. accounts: all road and equipment accounts, all general expenditures and other elements of investment accounts, and railroad property owned but leased to others. As required by statute, no depreciation or obsolescence shall be allowed as a deduction from the original cost of the railroad's assets enumerated above.

The following is an example of how the cost indicator of value is to be computed:

XYZ Railroad

Account	Amount
Road	$13,000,000
Equipment	9,000,000
Construction Work in Progress	1,000,000
Leased Property	500,000
General Expenditures	1,500,000
Cost Indicator	$25,000,000

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This cost indicator of value computed in accordance with this rule will bear a weighting of 25 percent of the total unit value estimate of the railroad's property, except in the case of bankrupt railroads, or railroads with no income to be capitalized as provided for in 13 MCAR § 1.0024 E.

C. Income approach to valuation. The income indicator of value will be calculated by averaging the Net Railway Operating Income (as determined by the I.C.C.) of the railroad for the most recent five years preceding the assessment. This average income shall be capitalized by applying to it a capitalization rate which will be computed by using the Band of Investment Method. This method will consider:

1. The capital structure of railroads.
2. The cost of debt or interest rate paying particular attention to imedded debt of railroads.
3. The yield on preferred stock of railroads.
4. The yield on common stock of railroads.

For 1979 and subsequent years this capitalization rate will be 11%.

An example of a computation of the capitalized income approach to value is as follows:

XYZ Railroad

Net Railway Operating Income	
1974	$ 1,500,000
1975	2,000,000
1976	2,600,000
1977	3,001,000
1978	2,600,250
Total	$11,701,250
Average	$ 2,340,250

Five year average Net Railway Operating Income Capitalized at 11% (2,340,250 ÷ 11%) equals $21,275,000.

The income indicator of value computed in accordance with this rule shall be weighted 50 percent of the total estimated unit value of the railroad's property except in the case of bankrupt railroads or railroads having no net operating income as provided for in 13 MCAR § 1.0024 F.; and railroads not meeting the requirements for the use of the stock and debt indicator of value. Where no stock and debt indicator of value is used the income indicator will be weighted 75%.

D. Stock and Debt approach to valuation. The "Stock and Debt" approach to value is the third method which will be used to estimate the unit value of the railroad operating property. This approach to value is based on the accounting principle: Assets = Liabilities + Equity. Therefore, when the value of a company's liabilities (debt) is found and this added to the worth of its stock, a value can be established for its assets (property).

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The use of this approach to value will be limited to only those railroads meeting certain qualifications listed below:

1. The stock of the railroad must be traded on either the New York or American Stock Exchange.

2. The bonds of the railroad must be traded or have a rating by either Standard and Poor's or Moody's rating services.

3. If the railroad is part of a diversified company the value of the railroad portion of the total stock price must be able to be separated on an earnings basis using the method described below.

XYZ Railroad

XYZ railroad is wholly owned by ABC Industries Inc.

Net Earnings of ABC Industries	$5,200,500
Net Earnings of XYZ Railroad	$2,600,250
% of XYZ net earnings to total conglomerate earnings	50%
Value of share of ABC Industries stock	$ 100
XYZ Railroad portion of stock value	$ 50

If a railroad has no net earnings, and is part of a conglomerate, then the stock and debt indicator of value will not be used.

The value of the stock used in the stock and debt method shall be an average of the month ending stock prices for the twelve months immediately preceding the assessment date of January 2nd. The value of the bonds, equipment obligations and conditional sales contracts and other long term debts shall also be an average of the cost of money quotes for the twelve months immediately preceding the assessment date of January 2nd. The source for these stock and bond prices shall be Standard and Poor's Stockguide, or other applicable financial service.

An illustration of a computation of the stock and debt approach to value is as follows:

XYZ Railroad Company

Shares of Common Stock issued x Average price for preceeding year	1,000,000 x $12 =	$12,000,000
Shares of Preferred Stock x Average price for preceeding year	100,000 x $15 =	$ 1,500,000
Rate and face value of bonds x Average price for class of bonds for preceeding year A rated 8% bonds $10,000 x 99% of par =		$ 9,900,000
Stock and Debt Indicator of Value		$23,400,000

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After the gross stock and debt indicator of value has been computed an allowance will be made for the effect, if any, of revenue from other than railway operations included in this indicator of value. This allowance shall be based on the ratio of a five year average of Net Revenue from Railway Operations, as determined by the I.C.C., to a similar five year average of Income Available for Fixed Charges as determined by the I.C.C. The five year average will be the most recent five years preceding the assessment date.

An example of this computation is as follows:

XYZ Railroad Company

	Net Revenue from Railway Operations	Income Available for Fixed Charges
1974	$ 3,000,000	$ 3,500,000
1975	4,000,000	4,300,000
1976	5,200,000	5,700,000
1977	6,000,000	6,800,000
1978	5,200,000	5,400,000
	$23,400,000	$25,700,000
Average	$ 4,680,000	$ 5,140,000

Ratio $4,680,000 ÷ $5,140,000 = 91%

Gross Stock and Debt Indicator of Value	$23,400,000
Ratio of Operating to Non-Carrier Earnings	91%
Net Stock and Debt Indicator of Value	$21,300,000

The stock and debt indicator of value computed in accordance with this rule will bear a weighting of 25 percent of the total unit value of the railroad's property, except in the case of bankrupt railroads, railroads in bankruptcy proceedings or railroads with no income to be capitalized as provided for in 13 MCAR § 1.0024 F.

E. Unit Value Computation. The estimated unit value of the railroad property will be the total of the three weighted indicators of value.

The following is an example of the computation of the unit value.

XYZ Railroad

Valuation Approach	Value	Weighting	
Cost indicator of value	$25,000,000	25%	6,250,000
Income indicator of value	21,275,000	x 50%	10,637,500
Stock and debt indicator of value	21,300,000	25%	5,325,000
		Unit Value	$22,212,500

The weighting shown above may vary from railroad to railroad, as provided

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for in 13 MCAR § 1.0024 B., C. and D. depending on the conditions and circumstances involved in each valuation. For example a railroad with no outstanding stock would not have a computation for a stock and debt indicator of value, and therefore the income indicator of value would be weighted 75%.

F. Railroads Operating at a Loss, and Bankrupt Railroads Involved in Federal Bankruptcy Proceedings, and Railroads Adjudged Bankrupt by a Federal Court. Railroads which are involved in Federal bankruptcy proceedings, adjudged bankrupt or railroads having no net railway operating income will be valued using the cost and stock and debt approaches to value. If the stocks or bonds of such railroads are not traded, or do not meet the other requirements for use of the stock and debt indicator of value then these railroads will be valued using the cost approach to value only.

13 MCAR § 1.0025 Allocation.

A. General. After the estimated unit value of the railroad property has been determined, the portion of value which is attributable to Minnesota must be established. This is accomplished through the use of certain allocation factors. Each of the factors in the allocation method shows a relationship between the railroad system operations in all states and its Minnesota operations. These relationships are expressed in a percentage figure. These percentages are then added and an average is computed. The resulting average of the factors, multiplied by the unit value, yields the Minnesota portion of the railroad property which will, after the adjustments described in § 1.0026, be subject to ad valorem tax in the State of Minnesota.

B. Allocation Factors. The factors to be considered in making allocations of unit values to Minnesota for railroad companies are:

1. Miles of railroad track operated in Minnesota divided by miles of railroad track operated in all states.

2. Ton miles of revenue freight transported in Minnesota divided by ton miles of revenue freight transported in all states.

3. Gross revenues from transportation operations within Minnesota divided by gross revenues from transportation operations in all states.

4. Original cost of road property in Minnesota divided by the original cost of road property in all states.

The following example illustrates the allocation method to be applied to the unit value of railroad property.

XYZ Railroad

Minnesota miles of track Total miles of track	$\frac{100}{500}$	= 20%
Minnesota ton miles of revenue freight Total ton miles of revenue freight	$\frac{2,200,000}{9,000,000}$	= 24%

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Minnesota gross transportation revenue Total gross transportation revenues	$10,000,000 $40,000,000	= 25%
Minnesota Cost of Road Property Total Cost of Road Property	$ 2,990,000 $13,000,000	= 23%
Total Minnesota Percent of Unit Value		92% 23%
		$5,108,875

Total Unit Value ($22,212,500) x Minnesota Percent (23%) = Minnesota Portion of Unit Value

13 MCAR § 1.0026 Adjustments for non-formula assessed property or exempt property. After the Minnesota portion of the unit value of the railroad company is determined property which is either exempt from taxation, such as pollution control equipment and personal property, or classified as non-operating will be deducted from the Minnesota portion of the unit value to the extent that it has been included in the computation of this value.

Property which has been included in the computation of the unit value but has been defined as non-operating property will be valued by the local assessor. The Minnesota portion of the unit value will be reduced by the original cost of this property. Only non-operating property located within the State of Minnesota will be eligible for this exclusion.

The railroad company shall have the responsibility to submit to the Commissioner of Revenue, in the form required by the Commissioner, such schedules of non-operating property as he may require.

In addition to non-operating property which will be valued and assessed locally a deduction from the Minnesota portion of the unit value will be made for personal property. The unit value method presupposes that the value of any one portion of the unit is interdependent upon all other elements of the unit; therefore, it is extremely difficult to make a separation of this value into real and personal property.

A percentage of the Minnesota portion of the unit value after deducting non-operating and exempt property will be excluded as personal property. This percentage will be computed in the following way:

The following I.C.C. accounts for property within Minnesota will be totaled:

That portion of coal and ore wharves determined to be personal property less applicable depreciation;

Communication equipment less applicable depreciation;

Roadway machines less applicable depreciation;

Shop machinery less applicable depreciation;

Power plant machines less applicable depreciation;

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Equipment, allocated to Minnesota on the basis of car and locomotive miles in Minnesota compared to total system car and locomotive miles, less applicable depreciation.

The total of these accounts will then be divided by the total of the Minnesota road, equipment, leased property, general expenditures, construction work in progress, and other elements of investment accounts; all less applicable depreciation. The resulting percentage will be used to determine the personal property amount of the Minnesota portion of the unit value. This portion will not be taxable for ad valorem purposes.

The following is an illustration of the computation for personal property exclusion.

XYZ Railway

Personal Property Account	Amount in Minnesota	Depreciation	Net Amount in Minnesota
Coal & Ore Wharves	$ 500,000	$ 250,000	$ 250,000
Communication Equip.	100,000	50,000	50,000
Roadway Machines	200,000	100,000	100,000
Shop Machinery	100,000	50,000	50,000
Power Plant Machinery	500,000	203,000	297,000
Equipment*	2,250,000	1,250,000	1,000,000
			$1,747,000

*Total Equipment Account	$9,000,000
Car and Locomotive Miles in Minnesota	1,000,000
Total Car and Locomotive Miles	4,000,000
Ratio of Minnesota to Total	25%
Minnesota Allocated Equipment Account	$2,250,000

Cost Account	Amount in Minnesota	Depreciation	Net Amount in Minnesota
Road	$2,990,000	$1,400,000	$1,590,000
Equipment	2,250,000	1,250,000	1,000,000
C.W.I.P.	800,000	–	800,000
General Expenditures	500,000	250,000	250,000
			$3,640,000

Minnesota Depreciated Personal Property Accounts		$1,747,000
Minnesota Depreciated Cost		$3,640,000
Ratio of Personal Property to Cost		48%
Minnesota portion of unit value	$5,108,875	
Personal Property exclusion at 48%	2,452,260	
Taxable Minnesota Portion of Unit Value	$2,656,615	

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13 MCAR § 1.0027 Apportionment.

A. General. After the taxable Minnesota portion of the railroad's unit value has been determined this value must be distributed to the various counties and taxing districts in which the railroad operates. This distribution will be accomplished by the Commissioner of Revenue through the use of certain apportionment components. Each of the components in the apportionment method is a reflection of the property owned or used by the railroad within a particular taxing district. The figures making up these components will be developed on the basis of information submitted by the railroad companies in annual reports filed with the Commissioner, and information supplied to the Commissioner by the various auditors and assessors.

B. Apportionment Components. There are three components which will be used in the distribution of the value of railroad property to the various taxing districts. they are: railroad operating land, miles of track, and railroad operating structures with an original cost of $10,000 or more.

1. Railroad Operating Land. The information for the computation of this apportionment component will be based on information submitted by both the railroads and the various county auditors and assessors. The railroad companies shall file with the Commissioner of Revenue each year, in conjunction with their Annual Reports required by 13 MCAR § 1.0023 A, the number of acres of railroad operating land owned or used by them in each taxing district in which they operate. The county auditor shall also be required to submit to the Commissioner of Revenue a report showing the number of acres of railroad operating land, detailed by owning railroad, in each taxing district within his county. If either the railroads or the auditors find that it is administratively impracticable to submit this information, the Commissioner shall make an estimate of the number of acres of railroad operating land within each taxing district and the normal width of the right-of-way used by the railroad. In addition, information relative to the current estimated market value of all land within the respective taxing districts will be obtained from the county or city assessors by a review of the Abstract of Assessment of Real and Personal Property which the various assessors are required to submit yearly to the Commissioner of Revenue in compliance with Minn. Stat. § 273.061, subd. 9. A review will also be made of the Abstract of Assessment of Exempt Real Property which is submitted to the Commissioner of Revenue by the various assessors in compliance with Minn. Stat. § 273.18.

The computation for the railroad operating land apportionment component will be accomplished annually in the following manner:

a. The average estimated market value per taxable acre within a specific taxing district will be calculated by dividing the estimated market value of all taxable land within the taxing district (as indicated by the most recent Abstract of assessment of Real and Personal Property) by the number of taxable acres within the taxing district. The number acres within a taxing district will be obtained from the most recent statistics available from the Land Management Information Center, State Planning Agency. The total

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number of acres will be adjusted to allow for non-taxable or exempt acres by subtracting these non-taxable or exempt acres from the total acres. The number of non-taxable or exempt acres will be obtained from the most recent Abstract of Assessment of Exempt Real Property. The following example illustrates this calculation.

Estimated Market Value of all Taxable Land Within Taxing District		$200,000
Total Area of Taxing District	210 Acres	
Non-Taxable or Exempt Acres	10 Acres	
Taxable Acres within Taxing District		200
Average Estimated Market Value per Acre		$ 1,000

b. This average estimated market value per taxable acre is then applied to the number of acres of railroad operating land within the taxing district to compute a gross railroad operating land component within the taxing district. The following example illustrates this computation:

Average Estimated Market Value Per Acre	$1,000
Acres of Railroad Operating Land	x 5
Gross Railroad Operating Land Component	$5,000

c. This railroad operating land component will then be adjusted. This adjustment is achieved by striking a ratio between the System Unit Value for all Minnesota railroads as described in 13 MCAR § 1.0024 E to the total of Investment in Railway Property Used in Transportation Service as defined by the I.C.C. for all railroad operating in Minnesota. This relationship will be computed annually and will then be applied to the Gross Railroad Operating Land Component to arrive at the Adjusted Railroad Operating Land Component. This adjusted land value will then be used as one element of the apportionment computation.

The following is an example of how the Adjusted Railroad Operating Land Component is to be computed:

Railroad	System Unit Value	Investment in Railway Prop. Used in Trans. Services
ABC Railway	$20,000,000	$ 40,000,000
FGH Railway	5,256,000	8,000,000
JKL Railroad	2,000,000	4,780,830
MNO Railroad	50,000,000	90,000,000
XYZ Railroad	22,212,500	25,000,000
	$99,468,500	$165,780,830

Total System Unit Value (99,468,500) ÷ Total Investment in Railway Property Used in Transportation Services ($165,780,830) = 60%

Gross Railroad Operating Land Component Within the Taxing District	$5,000
Adjustment Factor	60%
Adjusted Railroad Operating Land Component	$3,000

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2. Miles of Track. The information for the computation of this apportionment component will be based on information submitted by the railroads to the Commissioner of Revenue in conjunction with the Annual Report required by 13 MCAR § 1.0023 A. Each railroad will be required to list the miles of track they own in each taxing district within Minnesota. The track must be separated in two classes; main line track and all other track.

In order to make the miles of track in each taxing district compatible with the other apportionment components, the miles must be converted to dollars. This conversion will be computed annually. The conversion will be accomplished by adding together the following I.C.C. accounts for each railroad's investment in Minnesota; Account 1 Engineering, Account 3 Grading, Account 8 Ties, Account 9 Rails, Account 10 Other Track Material, Account 11 Ballast, Account 12 Track Laying. The total of these accounts will then be divided by the number of miles of track operated by the respective railroads within Minnesota to obtain a cost per mile figure. This will be used as the average cost per mile for track within Minnesota.

The following is an example of how the average cost per mile of track in Minnesota will be computed:

Railroad	Total of. Accounts # 1, 3, 8, 9, 10, 11, 12	Mileage Operated in Minn.
ABC Railway	$ 4,000,000	154
FGH Railway	800,000	42
JKL Railroad	500,000	20
MNO Railroad	7,450,000	290
XYZ Railroad	2,500,000	104
	$15,250,000	610

Total cost of track ($15,250,000) ÷ Total miles operated (610) = Average Cost per Mile of Track $25,000

An additional calculation is necessary to adjust this average cost per mile of track to allow for weighting. Mainline track shall be weighted at 1.5 times the cost of all other track; thus if the average cost per mile of track is $25,000, mainline track would be worth more than $25,000 per mile, while all other track would be worth less. The calculation for the average cost of both main line and all other track shall be made annually on an industry basis.

The calculation to determine the average cost per mile of mainline track and the average cost per mile of all other track will be computed in the following manner:

a. Total mileage operated will be multiplied by the average cost per mile to arrive at a total track cost.

b. Total mileage operated will be separated into the two types of track, main line and all other track.

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c. Main line track will be multiplied by 1.5 to arrive at adjusted main line miles.

d. Adjusted main line miles will be added to all other track miles to arrive at adjusted total track miles.

e. Total track cost will be divided by adjusted total track miles to arrive at the cost per mile of all other track.

f. The cost per mile of main line track will be computed by multiplying the cost per mile of all other track by 1.5.

An illustration of this computation is as follows:

Railroad	Mileage Operated	Main Line Miles	All other Track Miles
ABC Railway	154	96	58
FGH Railway	42	10	32
JKL Railroad	20	15	5
MNO Railroad	290	132	158
XYZ Railroad	104	52	52
	610	305	305

Total Mileage Operated	610
Average Cost Per Mile of Track	$ 25,000
Total Track Cost	$15,250,000

Main Line Miles	305
Weighting Factor	1.5

Adjusted Main Line Miles	457.5
Other Track Miles	305.0
Adjusted Total Track Miles	762.5

Total Track Cost	$15,250,000
Adjusted Total Track Miles	762.5
Average Cost Per Mile of Other Track	$ 20,000

Average Cost Per Mile of Other Track	$ 20,000
Weighting Factor	1.5
Average Cost Per Mile of Main Line Track	$ 30,000

After the per mile cost figures for main line and all other track are obtained, these per mile cost figures would be multiplied by the length of each type of track in a particular taxing district to obtain the value of the trackage in that district. The same cost figures will be used for all railroads operating in Minnesota.

3. Structures. The information for the computation of this apportionment component will be based on statements submitted by the railroads. These schedules shall be submitted annually to the Commissioner of Revenue in conjunction with the Annual Report required by 13 MCAR § 1.0023 A.

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The schedules shall show the location, by taxing district, of all operating structures owned by the reporting railroad within Minnesota with an original cost of $10,000 or more. The schedules shall list a description of the structure and the railroad's current original cost investment in the structure as it appears in the appropriate I.C.C. account.

An example of this list is as follows:

XYZ RAILROAD

Taxing District	Description	Original Cost
St. Paul, S.D. #625	Office Building	$400,000
Minneapolis, S.D. #1	Depot	20,000
Fridley, S.D. #16	Yard Tower	200,000
Anoka, S.D. #11	Engine and Car Shop	250,000
	Total	$870,000

C. Apportionment Computation. After the three apportionment components have been calculated for each taxing district in which the railroad operates the apportionment of the railroads taxable Minnesota portion of the unit value can begin. This apportionment is accomplished by totaling the value of the land, track and structure components as developed in 13 MCAR § 1.0027 B 1, 2 and 3 for each taxing district, then finding the sum of these totals for all the taxing districts in which the subject railroad operates. The taxable Minnesota portion of the railroad's unit value is divided by this total value of the three apportionment components for all taxing districts in which the railroad operates in order to arrive at a percentage. This resulting percentage is then applied to the total value of the three apportionment components for each specific taxing district. The figure produced by this multiplication process is the taxing district's share of the railroad's taxable Minnesota portion of the unit value. It is important to note that no more value can be distributed to the various taxing districts than that produced by the valuation process described in 13 MCAR § 1.0021 to 1.0026 inclusive.

The following example illustrates the apportionment process:

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	LAND COMPONENT				TRACK COMPONENT					STRUCTURES			
Taxing District	Aver. E.M.V. Per Acre	# of R.R. Opr. Acres	Gross R.R. Land Component	Adj. R.R. Land Component ¶ 60%	Miles of Main Line	Value of Main Line ¶ $30,000 Mile	Miles of all other Track	Value of All Other Track ¶ $20,000	Total Track Component	Structures At original cost	Total of 3 Components	% of 3 Components to Unit Value*	Taxing Dist. Portion of Unit Value
St. Paul, S.D. #625	$19,000	50	$ 950,000	570,000	8	$ 240,000			$ 240,000	$400,000	$1,210,000	37.87%	$ 458,285
Minneapolis, S.D. #1	20,000	80	1,600,000	960,000	12	360,000			360,000	20,000	1,340,000	37.87%	507,522
Fridley, S.D. #16	15,000	95	1,425,000	855,000	6	180,000	20	$ 400,000	580,000	200,000	1,635,000	37.87%	619,253
Coon Rapids, S.D. #11	13,000	70	910,000	546,000	9	270,000			270,000	-----	816,000	37.87%	309,059
Anoka, S.D. #11	12,000	20	240,000	144,000	4	120,000			120,000	250,000	514,000	37.87%	194,677
Ramsey, S.D. #11	10,000	60	600,000	360,000	11	330,000			330,000	-----	690,000	37.87%	261,336
Elk River, S.D. #728	6,000	5	30,000	18,000	2	60,000			60,000	-----	78,000	37.87%	29,542
Elk River Twsp., S.D. #728	2,000	20	40,000	24,000			8	160,000	160,000	-----	184,000	37.87%	69,690
Big Lake, S.D. #727	3,000	4	12,000	7,200			4	80,000	80,000	-----	87,200	37.87%	33,027
Big Lake Twsp., S.D. #727	1,000	100	100,000	60,000			20	400,000	400,000	-----	460,000	37.87%	174,224
			$5,907,000	$3,544,200		$1,560,000		$1,040,000	$2,600,000	$870,000	$7,014,200		$2,656,615

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*Taxable Minn. Portion of Unit Value / Total of 3 Components for All Taxing Districts $\frac{\$2,656,615}{\$7,014,200} = 37.87\%$

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CHAPTER ONE: TAX — CIGARETTE 1-29
TAX ON SALE OF CIGARETTES

Tax-Cig 1 Stamps—Where Affixed to Packages. On all packages containing twenty cigarettes of standard or king size or super king size to be distributed by him the distributor shall affix the adhesive tax stamps, or, if he is using a tax meter machine, the imprint made thereby, to the bottom of the package.

On all other packages of cigarettes the adhesive tax stamps may be affixed to any portion of the outside of the package.

Tax-Cig 2 Shipping of Unstamped Cigarettes into Minnesota by Licensed Outstate Distributors Prohibited. No licensed distributor engaged in the business without this State shall ship or transport cigarettes to retailers in this state, to be sold by those retailers, without first having affixed to each package of such cigarettes the proper Minnesota tax stamp.

Tax-Cig 3 Co-Mingling of Stamped and Unstamped Cigarettes Prohibited. No unstamped cigarettes shall be stored or kept behind the same counter or showcase over which cigarettes are sold to ultimate consumers, or within twenty-five feet of the cabinet, rack or place where cigarettes for sale to ultimate consumers are kept or stored.

Tax-Cig 4 Cigarette Tax Stamps — Design. Adhesive tax stamps shall be of the decalcomania type.

Tax-Cig 5 Cigarette tax stamps -- denomination, purchase and payment for. Tax stamps shall be purchased by the distributor only from the Commissioner of Revenue, Centennial Office Building, St. Paul, Minnesota 55145. All purchases of stamps at the rate specified in Minnesota Statutes, section 297.02, subdivision 1, clause 1, shall be made in multiples of 100 stamps. Stamps of any other denomination may be purchased in any quantity. Requisition forms for the purchase of adhesive tax stamps shall be furnished upon request by the commissioner. Each requisition shall be accompanied by a remittance in full (less discount allowed under Minnesota Statutes, section 297.03, subdivision 5) for the stamps requisitioned.

Mail orders for adhesive stamps will be accepted by the commissioner if the requisitions are prepared correctly and accompanied by proper remittance for the stamps requisitioned. In such case, the remittance must also include first class postage and registry fee. If requested, orders for stamps will be forwarded by express collect.

Tax-Cig 6 Discount on cigarette stamp. The discount on cigarette stamp purchases shall be at the rate specified in Minnesota Statutes, section 297.03, subdivision 5.

Tax-Cig 7 Use of Tax Meter Machines. In lieu of purchasing and using adhesive tax stamps, any licensed cigarette distributor may apply for permission to use a Pitney-Bowes Tax Meter Machine for the purpose of imprinting tax stamps upon packages containing twenty cigarettes of standard or

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king size or super king size to be distributed by him in the State of Minnesota. Such application shall be filed with the Commissioner of Taxation in triplicate.

All meters on tax meter machines, the use of which the commissioner has permitted, shall be under his direct control. All repairs to such meters shall be strictly prohibited except by a duly authorized representative of Pitney-Bowes, Inc.

Before tax meter machines, the use of which the commissioner has permitted, are installed for use the tax meters thereof shall be delivered by Pitney-Bowes, Inc., to the office of the Commissioner of Taxation for the first meter settings. Where practical, all subsequent meter settings will be made at the location of the tax meter machines on a regularly scheduled basis. Meters will be set only by authorized representatives of the commissioner, and the seals placed on said meters by said representatives shall not be broken by anyone other than a duly authorized representative of the commissioner.

Where it is impractical for a representative of the commissioner to make a special trip to the location of the tax meter machine for the purpose of setting the meter, the distributor or his authorized agent may bring the meter in person either to the office of the Commissioner of Taxation, Centennial Office Building, St. Paul, Minnesota 55145, or to the nearest county treasurer or banking institution authorized by the commissioner pursuant to Section 297.03, Subd. 12 for setting. In lieu of bringing the meter in person, the distributor may forward the meter by prepaid express to the office of the Commissioner of Taxation, Centennial Office Building, St. Paul, Minnesota 55145. After setting, the meter will be returned to the distributor by express collect. In no event shall a meter be forwarded to a county treasurer or banking institution by means other than personal delivery.

All inks used in tax meter machines must be purchased from Pitney-Bowes, Inc. Each order must be accompanied by a Cigarette Tax Ink Order Book supplied by Pitney-Bowes, Inc., with an entry in respect of such order made therein stating the date, quantity on hand, quantity ordered, ascending and descending meter register readings, purchase order number and signature and title of person making the order.

All ink imprints on packages must be clear and legible.

The Commissioner of Taxation reserves the right to refuse the continued use of a tax meter machine in any case where any of the provisions of this regulation are not complied with.

Every licensed distributor using a tax meter machine may, at the time of the meter setting, remit in full (less the discount allowed under Section 297.03, Subd. 5) the tax represented by the number of units for which the meter is set.

Every licensed distributor using a tax meter machine who elects to make a remittance of tax at the time of filing his monthly return shall file with the Commissioner of Taxation a corporate surety bond conditioned for the payment when due of all cigarette taxes represented by the imprinting of stamps by said machine. Said bond shall be made on prescribed Form CT-104C and shall be in an amount to be determined by the commissioner. Whenever it is the opinion of the commissioner that said bond is inadequate

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in amount to fully protect the state, the commissioner shall require an additional bond in such amount as he deems sufficient.

Every licensed distributor using a tax meter machine shall include in his monthly return to the commissioner a statement of the number of stamps imprinted by said machine during the month for which the return is submitted, and if he has not already remitted the tax represented by the number of units for which the meter was set, shall accompany said return with a remittance representing the face value of the number of stamps imprinted by said machine during such month (less the discount allowed under Section 297.03, Subd. 5).

Tax-Cig 8 Cancellation of Stamps. Cancellation of tax stamps, both adhesive and meter imprints, will not be necessary.

Tax-Cig 9 Replacement of Unused Adhesive Tax Stamps which have Become Mutilated or Unfit for Use. Unused adhesive stamps which for any reason become mutilated or unfit for use will be replaced by the Commissioner of Taxation upon compliance by the distributor with the following conditions:

(a) The distributor shall make a written application for replacement of stamps, setting forth in detail the number of stamps, the denomination of each and the reason why the stamps have become mutilated or unfit for use.

(b) The spoiled stamps shall be held by the distributor until an authorized agent or employee of the commissioner shall have inspected them.

(c) If the agent or employee of the commissioner is satisfied that the stamps are mutilated or unfit for use, he shall authorize their destruction. Such destruction shall take place in his presence and he shall issue a certificate setting forth the number and denomination of the stamps destroyed and the facts of destruction. A copy of the certificate shall be furnished to the distributor and the original shall be filed with the commissioner.

Replacement of the stamps will then be made if the records of the commissioner show that the spoiled stamps were purchased by the distributor seeking their replacement.

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Tax-Cig 10 Replacement of or credit for used tax stamps. Tax stamps which are affixed to packages being returned to the manufacturer, or affixed to packages which, or the contents of which, have become damaged and unfit for sale, will be replaced by the commissioner of revenue, upon compliance by the distributor with the following conditions:

(a) The distributor shall make an application for replacement of the stamps, stating the brands and number of packages damaged or to be returned to the manufacturer, the cause and type of damage or reason for return to the manufacturer, and the kind, number and denomination of stamps affixed to said packages.

(b) Said packages shall be held by the distributor until an authorized agent or employee of the commissioner shall call upon him.

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(c) As to the packages being returned to the manufacturer, the agent or employee of the commissioner may authorize defacement of the stamps affixed thereto, and said defacement shall be made under his supervision. He shall issue a certificate setting forth the kind, number and denomination of the stamps defaced, the brands and number of packages to returned to the manufacturer and the name and address of the manufacturer. A copy of the certificate shall be furnished to the distributor and the original shall be filed with the commissioner. If the distributor returns the packages directly to the manufacturer, he shall furnish the commissioner with a duplicate copy of the way bill or bill of lading of the packages returned. If the distributor delivers the packages to a local representative of the manufacturer for return, he shall furnish the commissioner with the representative's receipt for the packages, and also a certified copy of the manufacturer's credit memorandum to the distributor evidencing receipt of the packages by the manufacturer.

(d) As to the packages which have become damaged and unfit for sale, the agent or employee of the commissioner may authorize the destruction of both the packages and their contents and the stamps affixed thereto. Such destruction shall take place in his presence and he shall issue a certificate setting forth the kind, number and denomination of the stamps, the brands and number of packages of cigarettes destroyed and the facts of destruction. A copy of the certificate shall be furnished to the distributor and the original shall be filed with the commissioner.

After compliance with the above conditions, replacement of the stamps defaced or destroyed will be made.

Where the stamps affixed to the packages being returned to the manufacturer, or affixed to packages which, or the contents of which, have become damaged and unfit for sale, consist of imprints made by tax meter machines, credit will be allowed for all such imprints if the distributor complies with the foregoing conditions.

(e) If the commissioner is satisfied that the distributor utilizes procedures and maintains adequate records to insure full compliance with the provisions of Minnesota Statutes, chapter 297, he may waive any of the requirements of this regulation.

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Tax-Cig 11 Exchange of and Refunds on Tax Stamps. Adhesive tax stamps purchased by a distributor from the Commissioner of Taxation may be exchanged for stamps of other denominations upon written application of the distributor. All such applications shall be made on prescribed Form CT-212 which will be furnished by the Commissioner of Taxation upon request.

Cash refunds for unused adhesive tax stamps and unused tax meter units can only be made when the distributor discontinues business. No cash refund shall be made until the commissioner has had an opportunity to audit the records of the distributor and satisfy himself that no further tax is due. Before the refund is issued, all unused adhesive stamps must be returned to the commissioner and the tax meter cleared by an authorized representative of the commissioner.

Tax-Cig 12 Railroad and Sleeping Car Companies' Monthly Reports to the Commissioner. The monthly report which each railroad or sleeping car company licensed as a distributor is required to file shall be made in duplicate on prescribed Form No. CT-205. Each such report shall be complete and accurate and shall be verified by the person signing the same.

The original shall be filed with the Commissioner of Taxation on or before the eighteenth day of the succeeding calendar month and shall be accompanied by remittance of the tax due (less the discount allowed under

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Section 297.03, Subdivision 5). The copy shall be retained by the company as part of its records.

The monthly report shall be deemed to have been filed as herein required if postmarked on or before the eighteenth day of the month when due.

Tax-Cig 13 Distribution of Free Sample Packages—Monthly Reports to the Commissioner. Any cigarette manufacturer or person engaged as a common carrier in the transportation of persons authorized to distribute in Minnesota free sample packages of not more than ten cigarettes each without affixing stamps to said packages shall file a monthly report of samples distributed and shall accompany such report with the proper tax remittance. This shall be made on the prescribed Form No. CT-204; said forms to be furnished on request by the commissioner.

Tax-Cig 14 Applications for Distributors' and Subjobbers' Cigarette Licenses. Applications for cigarette distributors' and subjobbers' licenses shall be made on the prescribed Form CT-101. Application forms shall be furnished by the Commissioner of Taxation.

All questions on the application forms must be answered completely and answers must be made in ink or typed. All applications must be signed and acknowledged by the applicant or an officer thereof.

Tax-Cig 15 Distributors and Subjobbers' License Fees. If an application for a distributor's cigarette license for the current license period is filed with the commissioner on or before June 30, it shall be accompanied by a fee of $150.00; if said application is filed on or after July 1, the fee accompanying it shall be only $75.00.

If an application for a subjobber's cigarette license for the current license period is filed with the commissioner on or before June 30, it shall be accompanied by a fee of $12.00; if said application is filed on or after July 1, the fee accompanying it shall be only $6.00.

Tax-Cig 16 Corporate Surety Bonds in Support of Distributors' Licenses. Each application for a distributor's license shall be accompanied by a corporate surety bond, issued by a surety licensed to do business in Minnesota, in support of the license, in the sum of $1,000.00. All corporate surety bonds in support of licenses shall be made on prescribed Form CT-104A. Forms for such surety bonds shall be furnished by the Commissioner of Taxation.

Tax-Cig 17 Licensed Warehouse Records. Licensed warehouses handling deliveries or shipments of cigarettes to persons in Minnesota shall keep a true and accurate book record of all such deliveries or shipments. Such book record shall show the name and address of the consignee, the date of delivery or shipment, the brands and number of cigarettes delivered, and shall be available for inspection by the Commissioner of Taxation and his authorized agents and employees.

Tax-Cig 18 Receiving Records, Invoices and Inventory Records. Every licensed distributor shall maintain receiving registers on licensed premises in

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which shall be currently posted in respect to cigarettes received, the date, name of shipper and number of pieces received.

Every distributor shall preserve invoices of all cigarette purchases and sales except sales to the ultimate consumers. Sales invoices shall clearly specify quantities of cigarettes. Licensed distributors shall make invoices or records of all cigarettes transferred to retail outlets owned or controlled by them. No invoices shall be required for sales of cigarettes to the ultimate consumer at the address given in the distributor's license, provided he shall withdraw cigarettes for retail sales from his wholesale stock by use of a memo prepared at the time of withdrawal.

Every distributor shall, at the close of each period for which a return is required, take an inventory of unstamped cigarettes on hand. Cigarettes stamped with indicia of other states shall be considered unstamped cigarettes for Minnesota cigarette tax purposes.

Every distributor shall, at the close of the annual accounting period, take an inventory of stamped cigarettes. The commissioner may require that a distributor take an additional inventory or inventories of stamped cigarettes, if, in his opinion such inventory is or inventories are necessary to determine the correctness of the returns filed by the distributor. Cigarettes in vending machines and cigarettes transferred to retail stock on written memorandum should not be included in inventory reports.

Tax-Cig 19 Distributors' Monthly Returns to Commissioner. The monthly cigarette return which each Minnesota distributor is required to file shall be made in duplicate on prescribed Form No. CT-201. The monthly cigarette return which each out-of-state distributor is required to file shall be made in duplicate on prescribed Form No. CT-202. Forms for such returns shall be furnished by the Commissioner of Taxation.

Each return shall be complete and accurate and shall include any and all supporting schedules required by the commissioner.

The return shall be signed by the distributor or an officer thereof.

The original return shall be filed with the Commissioner of Taxation on or before the eigtheenth day of the succeeding calendar month. The copy shall be retained by the distributor. The monthly return shall be deemed to have been filed as herein required if postmarked on or before the eighteenth day of the month when due.

Tax-Cig 20 Cigarette Vending Devices — Visibility, Placement of Packages Therein. Every device for the vending of cigarettes in this state must conform to the following requirements:

(a) Partial visibility. Partial visibility shall include partial visibility from the front or from the back, provided that the back of the device is readily accessible to inspection. If the back of the device is not readily accessible to inspection, partial visibility must be afforded from the front.

(b) Visibility of packages. At least two packages in each magazine must be visible from the outside of the device.

(c) Placement of packages. All packages of cigarettes must be loaded in the magazines of the device so that the Minnesota cigarette tax stamps

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or tax meter imprints are clearly visible from the outside of the device as they come into view in the visible portion of each magazine therein.

Tax-Cig 21 Inspection of Cigarette Vending Devices: Seizure or Sealing. The Commissioner of Taxation or his authorized agents may demand access for the inspection of the contents of a cigarette vending device located in this state where ever and when ever deemed necessary in the enforcement of Sections 297.01 to 297.13 of the Minnesota Laws. If such access is denied, the commissioner or his authorized agents may seize the device in accordance with the provisions of Sections 297.08, Subdivision 2. In lieu of seizure, the commissioner or his agents may seal the device to prevent its use until inspection of the contents is satisfactorily permitted. The seals so placed by the commissioner or his agents may not be broken and/or removed by anyone other than the commissioner or his agents. Immediate seizure of the device under Section 297.08, Subdivision 2, will be made where the seals placed by the commissioner or his agents have been broken or removed other than by the commissioner or his agents.

Tax-Cig 22 Name and Address or Telephone Number of Owner of Cigarette Vending Devices. Every device for the vending of cigarettes in this state must carry the name and either address or telephone number of the owner, clearly visible from the front of the device.

Tax-Cig 23 Examination of Taxpayer's Records. For the purpose of determining the correctness of any return or of determining whether or not any person should have made a return or paid taxes under Sections 297.01 through 297.13, the commissioner shall have power to examine, or cause to be examined, any books, papers, records, or memoranda relevant to making such determination, including the taxpayer's retained copy of his return of income to the United States Government for any year, whether such books, papers, records, or memoranda are the property of or in the possession of the taxpayer or any other person or corporation. He shall further have power to require the attendance of any taxpayer or other person having knowledge or information in the premises to compel the production of books, papers, records, or memoranda by persons so required to attend, to take testimony on matters material to such determination, and to administer oaths or affirmations.

Tax-Cig 24 Commissioner to Appoint Examiners. For the purpose of making such examinations and determinations, the commissioner may appoint such officers, to be known as tax examiners, as he may deem necessary. These examiners shall be furnished proper credentials signifying their appointment as above. The credentials shall be signed by the commissioner and countersigned by the examiner.

It is the duty of every examiner to present his credentials to the taxpayer for the purpose of satisfying the taxpayer that he is duly authorized to examine the taxpayer's books, papers, records or memoranda relating to the return or the making of a return under Chapter 297.

Tax-Cig 25 Powers of Examiners. Such tax examiners shall have all the rights and powers with reference to the examining of books, records, papers, or memoranda, and with reference to the subpoenaing of witnesses, ad-

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ministering of oaths and affirmations, and taking of testimony conferred upon the commissioner by this chapter. The clerk of any court of record, or any justice of the peace, upon demand of any such examiner, shall issue a subpoena for the attendance of any witness or the production of any books, papers, records, or memoranda before such examiner. The commissioner may also issue subpoenas for the appearance of witnesses before him or before such examiners. The commissioner may appoint such referees as he deems necessary to review, singly or as a board of review, the reports of the tax examiners and petitions or complaints of taxpayers, and report thereon to the commissioner. Disobedience of subpoenas issued under this chapter shall be punished by the district court of the district in which the subpoena is issued as for a contempt of the district court.

Tax-Cig 26 Common Carriers — Reports. Reports of shipments of cigarettes transported from without this state to consignees located in this state other than public warehouses of first destination in this state licensed under Minnesota Statutes, Chapter 231, shall be made on Form CT-206 and shall be signed by a duly authorized official or representative of the carrier. The report shall be filed on or before the 10th day of the month following the month the deliveries of cigarettes were made.

In lieu of itemization of individual shipments on the report form, there may be attached thereto copies of each of the freight bills relating to shipments required to be reported and a notation made on the face of Form CT-206 as to the number of shipments required to be accounted for.

Where two or more persons or carriers are engaged in the transportation of a shipment of cigarettes from without the state to a consignee in this state, other than a public warehouse of first destination in this state licensed under the provisions of Minnesota Statutes, Chapter 231, the responsibility for filing the report of such shipment shall be that of the person or carrier who transported it into the state provided, however, that if the delivering carrier agrees to report the shipment, no report need be made by the carrier transporting it into the state.

Tax-Cig 27 Sales and Distribution of Tax Exempt and Tax Paid Cigarettes by State Institutions:

(a) **Gratuitous Distributions of Cigarettes by State Institutions.** Where cigarettes are purchased from appropriated funds for gratuitous distribution by the state to inmates of state institutions for the personal use or consumption of such inmates the tax imposed by Minnesota Statutes, Section 297.02, shall not be applicable.

(b) **Sales of Cigarettes by State Institutions.** All cigarettes purchased for resale in institutions of the state with exception of cigarettes to be sold at institutions under the control and management of the Commissioner of Corrections are subject to the tax imposed by Section 297.02. Payment of the tax on all packages sold must be evidenced by tax stamps affixed thereto.

Institutions acquiring unstamped cigarettes for resale shall cause the tax stamps to be affixed to each of the packages thereof, file monthly reports on or before the 18th day of each month with the Commissioner of Taxation fully accounting for all cigarettes received and stamped during the preceding month and cause payment of taxes due to be made to the Commissioner of Taxation.

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Institutions which acquire all cigarettes purchased for resale with tax stamps affixed to the packages thereof from cigarette distributors or subjobbers licensed under the provisions of Minnesota Statutes, Chapter 297, shall not be required to file monthly reports with the Commissioner of Taxation.

All orders for cigarettes placed with entities or persons other than Minnesota licensed distributors and/or subjobbers by or for state institutions other than institutions under the control and management of the Commissioner of Corrections must state in writing that the cigarettes ordered thereon are:

(1) to be disposed of by resale, or

(2) purchased from appropriated funds for gratuitous distribution to inmates or patients.

Where an institution makes gratuitous distributions of cigarettes not subject to the tax and also makes sales of taxed cigarettes, the co-mingling of tax exempt and taxed cigarettes is prohibited.

Tax-Cig 28 and 29 Reserved for Future Use.

CHAPTER TWO: TAX — CIGARETTE USE 30-39

TAX UPON USE OR STORAGE OF CIGARETTES BY CONSUMERS

Tax-Cig Use 30 Tax on Consumers. A consumer is any person who has title to or possession of cigarettes in storage for use or other consumption in this state. The tax is imposed upon every consumer who has acquired title to or has in his possession at any time unstamped cigarettes in quantities exceeding 200.

Tax-Cig Use 31 Cigarette Consumer's Return to Commissioner. A return is required to be filed by every consumer upon whom the tax is imposed. The return shall cover a period of one month and shall be filed on the 18th day of the month following the month in which the consumer became liable for a tax.

The return which is to be filed on the prescribed Form CT-203, shall be complete, accurate and include any and all supporting schedules required by the commissioner.

The return shall be signed by the consumer.

The return shall be deemed to have been filed as herein required if postmarked on or before the eighteenth day of the month when due.

Tax-Cig Use 32 Examination of Taxpayer's Records, Commissioner to Appoint Examiners, Powers of Examiners. All the provisions of Regulations 23, 24 and 25 shall be applicable to consumers under Sections 297.21 through 297.26.

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CHAPTER THREE: TAX — TOBACCO PRODUCTS 40-59

TAX ON TOBACCO PRODUCTS

Tax-Tob Prod 40 Free Samples, Tax on. Where tobacco products samples are distributed in this state by a manufacturer through its agents, the tobacco products tax is payable by such manufacturer. In such instances, the manufacturer shall file a return and report thereon the quantities of such tobacco products so distributed. The tax shall be computed on the usual wholesale sale price of such products.

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Tax-Tob Prod 41 Transfer of cigars or other tobacco products within the state.

A tax at the rate specified in Minnesota Statutes, section 297.32, subdivision 1, shall be imposed upon all tobacco products in this state to be paid as provided in Minnesota Statutes, sections 297.31 to 297.39 by any person engaged in business as a distributor thereof. Such tax shall be imposed at the time the distributor

(a) brings, or causes to be brought, into this state from without the state tobacco products for sale;

(b) makes, manufactures or fabricates tobacco products in this state for sale in this state; or

(c) ships or transports tobacco products to retailers in this state, to be sold by those retailers. The liability for the tax accrues at the time of receipt of tobacco products in this state by a distributor. A subsequent transfer from the original distributor to another distributor within this state does not relieve the original distributor from the tax liability. Therefore, no tax credit can be taken on tobacco tax returns for any transfers made within the state.

Tax-Tob Prod 42 Tobacco Products Consumer's Return to Commissioner. A consumer is any person who has title to or possession of tobacco products in storage, for use or other consumption in this state. The tax is imposed upon every consumer who has acquired title to or has in his possession at any time untaxed tobacco products in quantities of more than 50 cigars, more than ten ounces of snuff or snuff powder, more than one pound of smoking or chewing tobacco or tobacco products exclusive of cigarettes.

A return is required to be filed by every consumer upon whom the tax is imposed. The returns shall cover a period of one month and shall be filed on the eighteenth day of the month following the month in which the consumer became liable for the tax.

The return is to be filed on prescribed Form CT-303; shall be complete, accurate and include any and all supporting schedules required by the commissioner.

The return shall be signed by the consumer.

The return shall be deemed to have been filed as herein required if postmarked on or before the eighteenth day of the month when due.

Tax-Tob Prod 43 Applications for Distributors' and Subjobbers' Tobacco Products Licenses. Applications for tobacco products distributors' and subjobbers' licenses shall be made on the prescribed Form CT-101. Application forms shall be furnished by the Commissioner of Taxation.

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All questions on the application forms must be answered completely and answers must be made in ink or typed.

All applications must be signed and acknowledged by the applicant or an officer thereof.

Tax-Tob Prod 44 Distributors' Tobacco Products License Fees. If an application for a distributor's tobacco products license for the current license period is filed with the commissioner on or before June 30, it shall be accompanied by a fee of $37.50.

Each application for a distributor's tobacco products license shall be accompanied by a corporate surety bond issued by a surety licensed to do business in the State of Minnesota, in the sum of $1,000, conditioned upon the true and faithful compliance with all the provisions of Sections 297.31 to 297.39, and the payment of all taxes, penalties, accrued interest or any delinquent taxes which may be due the State of Minnesota. Said bonds shall be made on prescribed Form No. CT-104B which shall be provided by the Commissioner of Taxation. Whenever it is the opinion of the commissioner that said bond is inadequate in amount to fully protect the state, the commissioner shall require either an increase in the amount of said bond or additional bond in such amount that he deems sufficient.

Any bond required by Section 297.33 shall be kept in full force and effect during the entire period of the license.

Tax-Tob Prod 45 Subjobbers' Tobacco Products License Fees. If an application for a subjobber's tobacco products license is filed with the commissioner on or before June 30, it shall be accompanied by a fee of $10.00.

Tax-Tob Prod 46 Distributors' and Subjobbers' Tobacco Products License Fees for Part of a Year. If an application for a distributor's tobacco products license for the current period is filed on or after July 1, it shall be accompanied by a fee of $18.75.

If an application for a subjobber's tobacco products license for the current period is filed on or after July 1, the fee accompanying it shall be $5.00.

Tax-Tob Prod 47 Licensed Warehouse Records. Licensed warehouses handling deliveries or shipments of tobacco products shall keep a true and accurate book record of all such deliveries or shipments. Such book record shall show the name and address of the consignee, the date of delivery or shipment, the type of tobacco product, brand name and quantity delivered, and shall be available for inspection by the Commissioner of Taxation or authorized agents.

Tax-Tob Prod 48 Transportation of Tobacco Products — Reports.

(a) **Other than Common Carriers.** Any persons other than common carriers who transport into this state from without tobacco products other than cigarettes must file Form CT-305 with the Commissioner of Taxation except that any person who transports more than 50 cigars, more than 10 ounces of snuff or snuff powder, or more than one pound of smoking or chewing tobacco into this state for his own use or consumption and who files a Tobacco Products Consumer Return may fulfill the requirements of report-

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ing transportation of such products by indicating on the Tobacco Products Consumer's Return which of the items reported on such return were transported into the state by himself. Form CT-305 shall give descriptions of tobacco products brought into the state, date brought into the state, to whom delivered and date delivered, and shall be filed with the Commissioner of Taxation, Centennial Office Building, St. Paul, Minnesota, 55145, no later than 30 days after the tobacco products have been brought into the state.

This requirement for filing of reports referred to in this regulation shall not be applicable to consumers who import 50 cigars or less, 10 ounces of snuff or snuff powder or less, or one pound of smoking or chewing tobacco or less into this state; or licensed distributors who are required to file returns under provisions of Tobacco Products Tax Regulation 49.

(b) **Common Carriers.** Reports of shipments of tobacco products other than cigarettes transported from without this state to consignees located in the state other than public warehouses of first destination licensed under Minnesota Statutes, Chapter 231, shall be made on Form CT-206 and shall be signed by a duly authorized official or representative of the carrier. The report shall be filed with the Commissioner of Taxation, Centennial Office Building, St. Paul, Minnesota 55145, on or before the 10th day of the month following the month in which deliveries of tobacco products were made.

In lieu of itemization of individual shipments on the report form there may be attached thereto copies of each of the freight bills relating to shipments required to be reported and a notation made on the face of Form CT-206 as to the number of shipments required to be accounted for.

Where two or more persons or carriers are engaged in the transportation of a shipment of tobacco products other than cigarettes from without the state to a consignee in this state, other than a public warehouse of first destination in this state licensed under the provisions of Minnesota Statutes, Chapter 231, the responsibility for filing the report of such shipment shall be that of the person or carrier who transported it into the state provided, however, that if the delivering carrier agrees to report the shipment, no report need be made by the carrier transporting it into the state.

Common carriers transporting tobacco products other than cigarettes into Minnesota shall permit examination of their records relating to shipment of such tobacco products.

Tax-Tob Prod 49 Distributors' Monthly Returns to the Commissioner. The monthly tobacco products tax return which each distributor having a place of business in this state is required to file shall be made in duplicate on Form No. CT-301.

Every licensed distributor outside this state who ships or transports tobacco products to retailers in this state to be sold by those retailers is required to file a return on Form No. CT-302.

Each return shall be complete and accurate and shall include any and all supporting schedules required by the commissioner.

The return shall be signed by the distributor or an officer thereof.

The original return shall be filed with the Commissioner of Taxation on or before the eighteenth day of the succeeding calendar month. The monthly

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return shall be deemed to have been filed as herein required if postmarked on or before the eighteenth day of the month when due.

Tax-Tob Prod 50 Receiving Records. Every licensed distributor shall maintain receiving registers on licensed premises in which shall be currently posted with respect to tobacco products received, the date, name of shipper and number of pieces received.

Tax-Tob Prod 51 Sales and Distribution of Tax Exempt and Taxable Tobacco Products by State Institutions.

(a) **Gratuitous Distributions of Tax Exempt Tobacco Products Other Than Cigarettes by State Institutions.** Where tobacco products are purchased from appropriated funds for gratuitous distribution to inmates of state institutions for the personal use or consumption of such inmates the tax imposed by Minnesota Statutes, Section 297.32 shall not be applicable.

(b) **Sales of Taxable Tobacco Products by State Institutions.** All tobacco products purchased for resale in institutions of the state with exception of tobacco products to be sold at institutions under the control and management of the Commissioner of Corrections are subject to the tax imposed by Minnesota Statutes, Section 297.32.

Institutions acquiring tobacco products on which the tax has not been paid for purposes of resale shall file reports with the Commissioner of Taxation on or before the eighteenth day of each calendar month showing the wholesale sales price of each of such products acquired during the preceding month. Each return shall be accompanied by a remittance for the full tax liability shown therein less a discount of 2½ percent.

Where any institution acquires all tobacco products purchased for resale from a tobacco products distributor or subjobber licensed under the provisions of Chapter 297, it will be presumed that the tax on such products has been or will be paid by a licensed distributor and such institution shall not be required to file monthly reports with the Commissioner of Taxation.

All orders for tobacco products made by state institutions other than those under the administration and control of the Commissioner of Corrections must state in writing whether such order is for tobacco products;

(1) to be disposed of by resale, or

(2) purchased from appropriated funds for gratuitous distribution to inmates or patients.

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Tax-Tob Prod 52 Credit for tax paid on tobacco products. Credits will be allowed for tax paid on tobacco products under the following conditions:

(a) Sales.

(1) Sales of tobacco products to retailers located outside the state to be sold by those retailers. All such sales shall be listed on prescribed Form No. CT-301C, Schedule C. showing date and number of invoice, name and address of retailer and manufacturer's wholesale sales price unless permission is granted by the commissioner of revenue to furnish the information in some other manner.

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(2) Sales to consumers located without the state, to be consumed without the state. All such sales shall be listed on prescribed Form No. CT-301C, Schedule C, showing the date of sale, invoice number, name and address of the consumer and the manufacturer's wholesale sales price of the tobacco products sold unless permission is granted by the commissioner of revenue to furnish the information in some other manner.

A credit will not be allowed under any circumstances for a sale consummated or made in this state to consumers for consumption without this state nor shall such sales be listed on Form No. CT-301C.

(3) Sales to subjobbers without the state. All sales of tobacco products to subjobbers located without the state for resale outside the state shall be listed on prescribed Form No. CT-301C, Schedule C, showing the date of sale, invoice number, name and address of the subjobber and the manufacturer's wholesale sales price of the tobacco products sold. The distributor shall furnish the commissioner of revenue with a duplicate copy of the way bill or bill of lading of the tobacco products shipped to subjobbers outside the state.

(b) Return of tobacco products to the manufacturer by the distributor. All such returns of tobacco products shall be listed on the prescribed Form NO. CT-301B, Schedule B, showing date and number of credit memo or bill of lading number, the name and address of the manufacturer to whom shipped and the manufacturer's wholesale sales price.

If the distributor returns the tobacco products directly to the manufacturer he shall furnish the commissioner with a duplicate copy of the way bill or bill of lading of the tobacco products returned. If the distributor delivers the tobacco products to a local representative of the manufacturer for return, he shall furnish the commissioner with the representative's receipt for the tobacco products and also a certified copy of the manufacturer's credit memorandum to the distributor evidencing receipt of the merchandise by the manufacturer.

(c) Destruction of tobacco products. As to tobacco products which have become damaged and unfit for sale, the agent or employee of the commissioner may authorize destruction of same. Such destruction shall take place in his presence and he shall issue a certificate signed by the distributor and the agent or employee of the commissioner setting forth the type of tobacco products, brand name and quantities destroyed, facts of destruction and the manufacturer's wholesale sales price. A copy of the certificate shall be furnished to the distributor and the original shall be filed with the commissioner.

(d) If the commissioner is satisfied that the distributor utilizes procedures and maintains adequate records to insure full compliance with the provisions of Minnesota Statutes, chapter 297, he may waive any of the requirements of this regulation.

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Tax-Tob Prod 53 Examination of Taxpayer's Records, Commissioner to Appoint Examiners, Powers of Examiners. For the purpose of determining the correctness of any return or of determining whether or not any person should have made a return or paid taxes under Sections 297.31 through 297.39 all the provisions of Regulations 23, 24 and 25 shall be applicable.

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CHAPTER ONE: INH TAX 1-10

TRANSFERS—TAX IMPOSED AT DEATH

Inh Tax 1 An inheritance tax is imposed under this section when the transferor is a resident of this state and the transfer is by will or intestate succession. The requirement that the transferor die "possessed" of the property is not restricted to physical possession.

EXAMPLE 1: A, a Minnesota resident, dies, leaving taxable property to two minor surviving sons. Nine hours after A's death, one son, a Minnesota resident, dies. The interest in A's estate passing from the dead son to his brother is subject to an inheritance tax under this section.

Inh Tax 2 The transferor is a resident for purposes of this section if he is domiciled within this state. Whether a transferor will be considered as domiciled within this state will be determined according to the regulations dealing with domicile.

Inh Tax 3 Real property belonging to a resident transferor is subject to the inheritance tax only if the situs of the property is within this state.

Inh Tax 4 The interest of a resident vendor in an executory contract (including an earnest money contract and a contract for deed) to sell real property located in this state or elsewhere is intangible personal property for purposes of the inheritance tax.

EXAMPLE 1: X, a Minnesota resident, contracts to sell land located in Montana to Y. X dies before delivery of the deed. The interest of X under this contract is subject to the inheritance tax.

Inh Tax 5 Tangible personal property belonging to a resident transferor is subject to the inheritance tax if the permanent physical situs of the property is within this state.

EXAMPLE 1: X dies domiciled in Minnesota, leaving a sum of money in United States currency in a bank safe deposit box in Chicago. That money is not subject to an inheritance tax under this section.

EXAMPLE 2: X owns a number of rare paintings permanently housed in museums in New York City, Chicago, and Minneapolis. X dies while domiciled in Minnesota. Only those paintings housed in a museum in Minneapolis are subject to a tax under this section.

Inh Tax 6 Intangible personal property belonging to a resident transferor, whatever situate, is subject to the inheritance tax.

EXAMPLE 1: X, domiciled in Minnesota, is a partner in a manufacturing company located in State S. The partnership laws of State S, like the Uniform Partnership Act, do not regard a partner as owning an undivided share of specific partnership assets. Upon the death of X, his interest in the partnership is subject to the inheritance tax under this section.

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CHAPTER TWO: INH TAX 11-18

TRANSFERS IN CONTEMPLATION OF DEATH

Inh Tax 11 General Rule. The words "transfer in contemplation of death" mean a transfer with the thought of death as the dominant motive. A transfer prompted by the thought of death does not refer to the general expectation of death entertained by all persons, nor is it limited to apprehension of imminent death or cases where death is near at hand. A single motive rarely prompts a gift; the test is whether from all of the facts and circumstances, the dominant motive of the donor was one associated with death rather than life.

Inh Tax 12 Transfers Which may be in Contemplation of Death. A transfer of property by deed, grant, bargain, sale or gift is broadly interpreted and may include, but is not limited to: creation of an irrevocable trust for the benefit of another plus additions thereto; releasing, relinquishing a power of appointment as defined in M.S. § 291.01, Subd. 8 and the regulations thereunder; assignment of an annuity contract; purchase or assignment of a life insurance contract; permitting another to withdraw funds from a joint bank account which were deposited by the donor; creation of a joint tenancy in realty or personalty; permitting another to redeem United States Savings Bonds purchased by the donor, and registered in the names of the donor and that other person; termination of a joint tenancy; forgiveness of a debt; transfer of a future interest; renunciation of a share in an intestate estate; and outright gifts.

Inh Tax 13 Presumption. The statute provides that certain transfers within three years of death shall be deemed to have been made in contemplation of death. A transfer to be so deemed must constitute a material part of the property of the decedent, it must be in the nature of a final disposition and it must be without adequate and full consideration in money or money's worth.

(a) The presumption is inoperative if the value of the property transferred does not constitute a material part of the donor's total estate. Materiality is a question to be determined upon all of the facts of the case. The ratio the gift bears to the whole estate is important but not determinative. Where the decedent has made a series of gifts, the totality of the transfers is a relevant factor.

EXAMPLE 1: A, who is 83 years old and in poor health, gives realty worth $20,000 to his daughter. Two months later A dies. A's estate is valued at $500,000. Although $20,000 is substantial, it scarcely constitutes a material part of A's property.

(b) The statutory presumption does not apply where the property was transferred for "adequate and full consideration in money or money's worth". See Inh Tax Regs, Chap. Four regarding consideration.

Inh Tax 14 The words "unless shown to the contrary" mean that where the transfer is deemed to be in contemplation of death, the presumption can be negated by proof that thoughts commonly associated with life rather than death, prompted the transfer. Where several motives induced the decedent to make a gift, some associated with life and the others with death, the

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taxpayer fails to overcome the presumption if he cannot establish the dominance of the living motives. Statements or expressions of the decedent concerning his state of mind or intentions at the time of the transfer are relevant, although not conclusive as to his intention. Objective factors such as age, physical and mental conditions, nearness to death, relationship of the parties, and the circumstances surrounding the transfer are relevant to the decedent's motives.

Examples of motives associated with life are the desire to reduce income taxes, to aid a son in business, to see children enjoy property, to reward employees or business associates, to shift management of property upon retirement, to carry out the desires of a recently deceased spouse, and to aid relatives undergoing financial hardship. Examples of motives associated with death are the desire to avoid inheritance and estate taxes, to alter the distribution that would take effect under a will, and to partially or wholly substitute intervivos transfers for a testamentary disposition.

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CHAPTER THREE: INH. TAX 19-32

TRANSFERS INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH

Inh Tax 19 A "transfer intended to take effect in possession or enjoyment at or after death" includes:

Any inter vivos transfer of property in trust or otherwise, to the extent that the transferor retains a life estate or a right of beneficial use, possession, enjoyment, or to the income from such property for his life or for a period which does not in fact end before his death, whether the life estate or right to beneficial use, possession, enjoyment, or income is reserved by the terms of the instrument of transfer or by appurtenant contract or reconveyance.

The transferor shall be deemed to have retained a life estate or a right to the beneficial use, possession, enjoyment, or income from any property transferred in trust by another person, to the extent that the transferor received any such estate or right and furnished the consideration for the creation of such trust.

EXAMPLE 1: X, a 60 year old man, conveys Blackacre in fee to his son Y. Y then reconveys to X a lease of Blackacre for a term of 50 years. The conveyance of Blackacre by X to Y in fee is a transfer intended to take effect in possession or enjoyment at or after death.

EXAMPLE 2: Pursuant to an agreement between X and Y, X creates a trust paying the income to Y for life, the remainder to Y's issue and Y creates a trust of equal value paying the income to X for life, remainder to X's issue. X is regarded as having retained the right to income for life of the trust created by Y and the property subject to that trust is taxable as a transfer of property by X intended to take effect in possession and enjoyment at or after his death. Similarly, Y is regarded as having retained a right to the income for life of the trust created by X and the property subject to that trust is taxable as a transfer of property by Y intended to take effect in possession and enjoyment at or after death.

However, the vesting in possession and enjoyment of a remainder interest upon the death of a transferee—life tenant is not taxable under this Chapter.

EXAMPLE: A transfers Blackacre to B for life with remainder to C and his heirs. B dies. The vesting in possession and enjoyment of C's remainder interest upon B's death is not a taxable transfer under this Chapter.

Inh Tax 20 In the case of any intervivos transfer, whether in trust or otherwise, regardless of whether the transferor retains any legal or beneficial interest therein, if, because of the death of the transferor, there is a succession by or increase of enjoyment and dominion on the part of any beneficiary, such transfer as to such beneficiary is intended to take effect in possession and enjoyment at or after death and is taxable under this section.

EXAMPLE 1: A irrevocably and unconditionally transfers property in trust with income to B for the life of A, remainder to B. Upon A's death, B will receive the principal of the trust. The transfer of the principal is a "transfer intended to take effect in possession or enjoyment at or after death".

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EXAMPLE 2: B transfers property in trust with income to B's wife for life or until such time as she may remarry, remainder to B's children on the death of the survivor of B and his wife. The trust also provides that the income be payable to B's children in the event that B's wife dies prior to B. Upon the death of B, the value of the remainder is subject to the inheritance tax under this subdivision.

However, no reversionary interest retained by a transferor of property shall render such property taxable under this section if the death of the transferor does not enhance the interests of the transferees of such property.

Inh Tax 21 Any intervivos transfer, whether in trust or otherwise, in which the income or enjoyment or possession of the transferred property is subject (at the time of the transferor's death) to any change through the exercise of a power in the transferor (in whatever capacity exercisable) to alter, amend, revoke, or terminate is taxable under this section.

(a) A power to alter, amend, revoke, or terminate includes a power exercisable either by the transferor alone, or by the transferor and any other person or persons not having a substantial adverse interest in the property transferred.

(b) A power to alter, amend, revoke, or terminate does not include:

(1) A power held solely by a person or persons other than the transferor whether or not the exercise of such power would be substantially adverse to the interest of such person or persons.

(2) A power held by the transferor exercisable only with the consent of all parties having an interest (whether vested or contingent) in the transferred property, which power adds nothing to the rights of the parties under Minnesota Law.

(3) A power held by the transferor exercisable only in conjunction with a person having a substantial adverse interest in the property.

(4) A power held by the transferor exercisable only in conjunction with several persons some or all of whom hold a substantial adverse interest.

Inh Tax 22 A "transfer intended to take effect in possession or enjoyment at or after death" does not include a transfer for an adequate and full consideration in money or money's worth. The full value of the property transferred rather than the value of the rights or interests reserved or the value of the remainders is controlling. See Inh Tax Regs Chapter Four regarding consideration.

Inh Tax 23 A refund feature under an annuity contract purchased by a decedent annuitant is taxable as a transfer intended to take effect at the death of such decedent.

EXAMPLE: H purchases an annuity for $25,000 containing a refund feature in favor of his wife W and dies after receiving annuity payments totaling $15,000. The refund feature of $10,000 payable to W is taxable under this section.

Inh Tax 24 A survivor's annuity under an annuity contract purchased by a decedent annuitant is taxable as a transfer intended to take effect at the death of such decedent.

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EXAMPLE 1: H purchases an annuity payable to himself for life and following his death to his wife W for her life. H dies, W surviving. The value of W's survivor's annuity is taxable as a transfer intended to take effect at H's death.

EXAMPLE 2: H purchases an annuity payable to H and his wife W for their joint lives, and to the survivor for the life of the survivor. H dies, W surviving. The value of W's survivor's annuity is taxable as a transfer intended to take effect at H's death.

Inh Tax 25 If a decedent who was a covered employee under any pension, profit sharing, stock bonus, annuity or other deferred compensation plan has made contributions to such plan and has designated a beneficiary of benefits thereunder, such benefits are transfers intended to take effect at death to the extent that such benefits are attributable to such contributions. However, social security benefits and benefits under the railroad retirement act are not taxable under this paragraph.

Inh Tax 26 Benefits attributable to employer contributions and receivable by any beneficiary (other than the estate of the decedent employee) under any pension, profit sharing, stock bonus, annuity or other deferred compensation plan which qualifies for exemption under M.S. § 291.065 are exempt from the tax imposed by this Chapter. See the regulations regarding such exemption. Such benefits receivable by the estate of the decedent employee shall (subject to the exception stated in Inh Tax Reg 19 of this chapter) be taxed as transfers by will or intestacy under M.S. § 291.01, Subd. 1 (1) and (2).

Inh Tax 27 Benefits attributable to either employer or employee contributions and receivable by any beneficiary under any pension, profit sharing, stock bonus, annuity or other deferred compensation plan which are not taxable or exempt under Inh Tax 17 and 18 of this chapter shall be taxed as transfers intended to take effect at death to the extent indicated in the following provisions of this paragraph:

(a) No payment attributable to employer contributions and providing death benefits for any beneficiary of a decedent employee is taxable under this Section if neither such decedent nor any such beneficiary had any legally enforceable right to receive such payment at any such time prior to the receipt thereof by such beneficiary.

(b) Any payment made after the death of a decedent employee to any beneficiary under any plan providing death benefits wholly attributable to employer contributions constitutes a taxable transfer under this section, if such death benefits are not subject to withdrawal by the employer at or after the death of the employee, in the following situations:

(1) Where the decedent employee has the power to designate or alter the designation of one or more beneficiaries of any such payment.

(2) Where the decedent employee has the power to elect or alter any death benefit or benefits under any such plan. For example, taxable powers under this subparagraph include the power to elect or alter,

(aa) a lump sum death benefit,

(bb) a refund feature under any decedent employee's retirement annuity,

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(cc) a survivorship annuity for the benefit of a decedent employee's beneficiary, or

(dd) a separate annuity for the benefit of any such beneficiary.

(3) Provided however that neither a decedent employee's power to designate or alter the designation of beneficiaries under subparagraph (1), nor his power to elect or alter any death benefit under subparagraph (2) shall render any such payment taxable under this section if all such powers were irrevocably exercised by the employee during his lifetime and at a time when any such payment was subject to withdrawal by the employer.

Inh Tax 28 If upon the death of a decedent any person has a legal right to acquire an interest in property owned by such decedent for a price less than the full and true value thereof (computed without regard to such right) the acquisition of such interest by such person is a transfer to him taxable under this section to the extent of the difference between such price and such full and true value unless such person obtained the legal right to acquire such interest in an arm's length business transaction with the decedent. The term "arm's length business transaction" as used herein means a business bargain between such person and the decedent wherein each sought to obtain the maximum consideration in money or money's worth therefrom. See also Inh Tax Regs, Chapter Four of these regulations regarding adequate and full consideration, and the example therein.

EXAMPLE 1: F and S, father and son, each owned 100 of the 200 outstanding shares of X corporation. F granted S an option to purchase F's shares from his estate upon his death for $5,000 (the full and true value of the shares when the option was granted). F made no provision for revision of the option price to reflect subsequent appreciation in the value of his shares, intending that any such appreciation pass to S gratuitously. F died when the full and true value of his shares was $20,000 and S exercised his option, acquiring F's shares for $5,000. S was the recipient of a transfer taxable under this section to the extent of $15,000.

EXAMPLE 2: From 1953 to F's death, F and his brother B each owned 500 of the 1,000 issued shares of X Corporation. During this period, the brothers managed the corporation, and both brothers were married and had children. In 1958, F and B agreed that in the event of the death of either, the decedent's family should not continue to own X corporation stock since neither family was in a position to contribute to management and conflict might well arise with respect to matters of corporate policy between the survivor and the family of the deceased.

Accordingly, in 1958, X Corporation, F and B entered into a stock purchase agreement providing as follows: (a) Upon the death of the first to die, the corporation would purchase his shares at $200 per share. (b) The agreed price might be changed by mutual agreement of F, B and X Corporation. (c) Since X Corporation's business involved the use of substantial amounts of capital, the price should in any event be adjusted upon the death of the first shareholder to die to reflect changes in book value occurring since the date of the last price determination by the parties.

At the date of the stock purchase agreement, the book value of the X corporation stock was $150 per share. In 1960, when book value was $170 per share, the parties mutually agreed upon a price per share of $230. In 1962, when book value was $200 per share and full and true value was $300

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per share, F died and the corporation purchased his 500 shares at a price of $260 (i.e., the $230 price fixed in the agreement adjusted to reflect the $30 per share change in book value since the date of last valuation by the parties).

Since, upon the facts, it appears that the stock purchase agreement was entered into in the course of an arm's length business transaction between F, B and X Corporation, the transfer of F's shares to X Corporation for a price $20,000 less than their full and true value will not be taxed as a transfer intended to take effect in possession or enjoyment at or after death under this Chapter.

EXAMPLE 3: E, an employee of X corporation, was permitted under an employee incentive plan to purchase 100 shares of X corporation stock at their book value of $100 per share when their full and true value was $150 per share. However, E took these shares subject to X's option to reacquire them from E's estate upon his death at their then book value. Upon E's death, X reacquired the 100 shares at a price of $200 per share (their then book value), and their then full and true value was $300 per share. The exercise by X of its option was not a transfer taxable under this section.

Inh Tax 29 A payment by an employer to a surviving spouse made pursuant to M.S. § 181.58 is not a transfer intended to take effect in possession or enjoyment at or after death and is not taxable under this Chapter.

Inh Tax 30 Where a United States savings bond is purchased, payable on the purchaser's death to a named survivor, the right of such survivor to the proceeds of the bond is taxable as a transfer intended to take effect in possession or enjoyment at or after death. For the applicability of an inheritance tax to savings bonds purchased in the co-ownership form, see Chapter Ten of these regulations regarding jointly owned property.

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CHAPTER FOUR: INH TAX 33-40

CONSIDERATION

Inh Tax 33 No transfer is a taxable event under M.S. § 291.01, Subds. 1, 2 and 3 if the transfer is made in exchange for adequate and full consideration in money or money's worth.

Inh Tax 34 The term "adequate and full consideration" means consideration equal to the full and true value of the property transferred. Where there is a transfer for less than adequate and full consideration, the transferee is taxable (unless the transfer is made in the course of an arm's length business transaction as hereinafter defined), but the transferee is taxable only to the extent of the excess of the full and true value of the property (as of the applicable valuation date) over the consideration in money or money's worth received by the transferor.

Inh Tax 35 The term "money or money's worth" means money, or property, services or other benefits which have an ascertainable value in money.

EXAMPLE 1: A bequeaths $1,000 to B in satisfaction of A's promise to do so if B would give up smoking for the balance of A's life. B's $1,000 legacy is taxable under this Chapter since A did not receive consideration in money or money's worth notwithstanding the fact that B's conduct in giving up smoking was sufficient consideration to render A's promise enforceable under the laws of contracts.

EXAMPLE 2: Prior to their marriage, H and W enter into an antenuptial contract whereby H agrees to bequeath $100,000 to W by will and W agrees not to assert any further marital property rights in H's estate. H bequeaths the $100,000 to W in accordance with the contract. W's $100,000 legacy is taxable under this Chapter since H did not receive consideration in money or money's worth for the bequest.

Inh Tax 36 A transfer for less than adequate and full consideration in money or money's worth is not taxable under M.S. § 291.01, Subds. 1, 2 and 3 if it is made in the course of an arm's length business transaction free from donative intent. The term "transfer made in the course of an arm's length business transaction" means a transfer which is made in performance of a business bargain between the transferor and the transferee wherein the transferor sought to obtain the fair consideration in money or money's worth in exchange for the transfer.

EXAMPLE: From 1953 to F's death, F and his brother B each owned 500 of the 1,000 issued shares of X Corporation. During this period, the brothers managed the corporation, and both brothers were married and had children. In 1958, F and B agreed that in the event of the death of either, the decedent's family should not continue to own X corporation stock since neither family was in a position to contribute to management and conflict might well arise with respect to matters of corporate policy between the survivor and the family of the deceased.

Accordingly, in 1958, X Corporation, F and B entered into a stock purchase agreement providing as follows: (a) Upon the death of the first to die, the corporation would purchase his shares at $200 per share. (b) The agreed price might be changed by mutual agreement of F, B and X Corpora-

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tion. (c) Since X Corporation's business involved the use of substantial amounts of capital, the price should in any event be adjusted upon the death of the first shareholder to die to reflect changes in book value occurring since the date of the last price determination by the parties.

At the date of the stock purchase agreement, the book value of the X corporation stock was $150 per share. In 1960, when book value was $170 per share, the parties mutually agreed upon a price per share of $230. In 1962, when a book value was $200 per share and full and true value was $300 per share, F died and the corporation purchased his 500 shares at a price of $260 (i.e., the $230 price fixed in the agreement adjusted to reflect the $30 per share change in book value since the date of last valuation by the parties.)

Since, upon the facts, it appears that the stock purchase agreement was entered into in the course of an arm's length business transaction between F, B and X Corporation, the transfer of F's shares to X Corporation for a price $20,000 less than their full and true value will not be taxed as a transfer intended to take effect in possession or enjoyment at or after death under this Chapter.

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CHAPTER FIVE: INH TAX 41-44

TRANSFERS OF INTANGIBLES USED OR HELD BY NONRESIDENTS

Inh Tax 41 In General. Any transfer of intangibles, otherwise taxable under this chapter, is **not** subject to the inheritance tax if the intangibles were used or held by a person, or transferred by reason of the death of a person, who was not a resident of this state at the time of his death. This exclusion applies whether the intangibles were used or held in trust or otherwise. However, the transfer of intangible property owned by a resident of this state **is taxable** regardless of where the intangible property is located.

Inh Tax 42 Definitions.

(a) Transfer. The term "transfer" as used in this paragraph, is defined in the regulations under the opening paragraph of this subdivision.

(b) Intangibles. The term "intangibles" refers to personal property of a type which is merely representative or evidence of value. . . . It describes a legal relationship between persons which ordinarily gives the holder a cause of action permitting him to enforce a debt or some other legal right. It includes, but is not limited to, stocks, bonds, notes (whether secured or unsecured), bank deposits, accounts receivable, patents, trademarks, copyrights, good will, life insurance policies, mortgages and other choses in action. Currency is tangible property; its transfer is taxable only by the state of its situs.

An interest in a Minnesota partnership owned by a nonresident transferor is an "intangible" for purposes of this subparagraph since, under Minnesota law, a partner does not have an interest in specific partnership assets.

(c) Resident. The term "resident" as used in this paragraph, is defined in the regulations under subpart (b) of this subdivision.

EXAMPLE: A, a Michigan resident, owns 5,000 shares of stock, a controlling interest in X, a Minnesota Corporation and a bank account. The stock certificates have never left Minnesota; A has kept them in a Minneapolis bank in a safe deposit box. A dies and the shares pass to B under A's will. B, A's brother, is the president and managing director of X and a Minnesota resident. This transfer is not subject to the Minnesota Inheritance Tax; the shares of stock are "intangibles" and A was a nonresident. The fact that the shares of stock may have acquired a "business situs" in Minnesota is no longer material.

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CHAPTER SIX: INH TAX 45-52

NONRESIDENT DECEDENTS

Inh Tax 45 An inheritance tax is imposed under this section when the transferor is a nonresident of this state at the time of his death and the transfer is

(a) by will, or

(b) by intestate succession, as defined in M.S. Chapter 525 for real property or in accordance with the intestate law of the domicile of the transferor for tangible personal property.

Inh Tax 46 The transferor is a nonresident for purposes of this section if he is not domiciled within this state. Whether a transferor will be considered as domiciled within this state will be determined according to the regulations dealing with domicile.

Inh Tax 47 Real property (including the interest of a vendee under an executory contract for the purchase of real property) located in this state belonging to a nonresident is subject to the inheritance tax.

EXAMPLE 1: X, a nonresident of Minnesota, contracts to purchase land located in Minnesota from Y, X dies before receipt of the deed. The interest of X under this contract is subject to the inheritance tax.

Inh Tax 48 The interest of a nonresident vendor in an executory contract for the sale of real property located within this state is not subject to the inheritance tax.

EXAMPLE 1: X, a nonresident of Minnesota, contracts to sell land located in Minnesota to Y. X dies before delivery of the deed. The interest of X under this contract is not subject to the inheritance tax.

Inh Tax 49 Tangible personal property having permanent physical situs within this state belonging to a nonresident transferor is subject to the inheritance tax.

Inh Tax 50 Intangible personal property belonging to a nonresident transferor is not subject to the inheritance tax.

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CHAPTER SEVEN: INH TAX 53-62

TAXABLE TRANSFERS—DISCLAIMERS—COMPROMISES

Inh Tax 53 The opening clause of M.S. § 291.01 provides that the inheritance tax is imposed upon any transfer of property, real, personal, or mixed, or any interest therein, or income therefrom in trust or otherwise, to any person, association, or corporation, except county, town or municipal corporations within the state, for strictly county, town or municipal purposes, in the cases provided in subdivisions one through five of such section. The term "transfer" as used therein means any transaction which is taxable under such subdivisions.

Inh Tax 54 No provision is made under this chapter for forgiveness of inheritance tax upon a transfer of property consisting of items of income in respect of a decedent under M.S. § 290.077. Therefore, the fact that such items are included in a transfer otherwise taxable under M.S. Chapter 291 does not affect the determination of the inheritance tax due in respect of such transfer.

EXAMPLE: H, executor of the estate of E, deceased, has rendered services as such executor although the amount of H's commissions has not been determined or allowed by the Probate Court. H dies. Subsequently, the Probate Court determines and allows such commissions and they are paid to H's personal representative. The transfer of such commissions by will or intestacy to H's testate or intestate beneficiaries is a transfer taxable under this Chapter.

Inh Tax 55 If the purchaser of property procures the transfer thereof by the seller to a third party, such transfer is taxable under this Chapter upon the purchaser's death to the extent that the transfer of such property to the third party by the purchaser would have been a taxable transfer under this Chapter.

EXAMPLE: F, in contemplation of death, purchases Blackacre from X who, at F's request, conveys Blackacre to F's son S. F dies within three years of the date of such conveyance and the consideration which F paid for Blackacre was a material part of F's property. The conveyance of Blackacre by X to S is a taxable transfer from F to S under this Chapter. See M.S. § 291.01, Subd. 1(3) regarding transfers in contemplation of death and the Regulation regarding such transfers.

Inh Tax 56 A death tax imposed on legatee A, which is required to be borne by some other legatee, shall constitute a taxable legacy to A and a diminution of the legacy taxable to such other legatee.

EXAMPLE: X bequeaths $100,000 to S and provides that the residue of his estate shall go to D. X's will provides that all death taxes shall be paid from the residue of his estate. The amount of Minnesota inheritance taxes imposed on the legacy to S shall constitute an additional legacy to him taxable under the provisions of this Chapter. The amount of the inheritance taxes assessed against S paid out of the residue shall constitute a reduction in the value of the residue taxable to D.

Computing the tax on tax does not present much difficulty except in the cases where this addition to the amount taxable requires the use of two rates.

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EXAMPLE 1: H's will, which bequeaths $100,000 to W, his widow, provides that death taxes shall be paid from the residue. The computation is as follows:

(1) Tax on $100,000	$1,900.00
(2) Tax on $1,900 at applicable rate of 4%	76.00
(3) Tax on $76.00 at applicable rate of 4%	3.04
(4) Tax on $3.04 at applicable rate of 4%	.12
(5) Tax on $ .12 at applicable rate of 4%	0
Total tax and tax on tax	$1,979.16

Where the legacy and the tax on tax, which constitutes an additional legacy, are in a single bracket the total tax and tax on tax can be quickly computed by dividing the tax on the legacy by 100% less the rate of tax imposed for that particular bracket. In the above example the initial tax is $1,900.00 and the rate of tax for a widow receiving a legacy which falls between $100,000 and $150,000 is 4%. Dividing $1,900.00 by .96 (100% less 4%) results in a total tax of $1,979.16. W, therefore, has received a legacy of $101,979.16. This computation may be proved as follows:

Tax on $100,000 is	$1,900.00
Tax on $1,979.16 is	79.16
Total tax	$1,979.16

EXAMPLE 2: Assume the same facts as in Example 1 except that the legacy to W is $99,000.00.

(1) Legacy to W		$ 99,000.00
(2) Tax thereon at applicable rate of 3%		1,870.00
(3) The next higher bracket		100,000.00
(4) Amount necessary to bring taxable estate to next bracket		1,000.00
(5) Tax on (4) at applicable rate of 3%		30.00
(6) Difference between $1,870.00 (#2) and $1,000.00 (#4)		870.00
(7) Amount to be taxed at next higher rate of 4%		900.00
(8) $900.00 at 4%		36.00
(9) $36.00 at 4%		1.44
(10) $1.44 at 4%		.06
(11) Cumulative Total		
# (2)	$1,870.00	
# (5)	30.00	
# (8)	36.00	
# (9)	1.44	
#(10)	.06	
Total tax and tax on tax	$1,937.50	

Note: The method used in example 1 above can be applied to the $900.00 taxable as set out in (#7) of this example. Divide $900.00 by .96. The

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quotient is $937.50. Add this to the tax as computed in (2) and (5). The total of the tax is $1,937.50. The accuracy of this figure is checked by computing the tax on $100,937.50.

Tax on $100,000.00 = ...	$1,900.00
Tax on excess of $937.50.....	37.50
Total tax	$1,937.50

Inh Tax 57 Bona Fide Contests. Where there is a contest between the beneficiaries named in the will or where the instrument is attacked by someone claiming under the laws of intestacy, the tax will be assessed in accordance with the rights of the litigants as finally determined by the courts. Where the dispute is resolved by a settlement between the parties and such settlement is approved by the Probate Court, the tax will be assessed in accordance with the terms of such agreement unless such settlement appears to have been entered into chiefly to avoid or diminish the tax. Where a court of competent jurisdiction, as a result of a contested case, determines that the share to which the litigants are entitled varies from that provided for in the terms of the trust instrument, or approves a settlement between the litigants which alters the terms of the trust instrument, the tax will be assessed in accordance with such decree or settlement unless such contested case appears collusive and to have been instituted chiefly to avoid or diminish the tax.

EXAMPLE 1. F, whose death occurred on February 1, 1968, left 10% of his estate to his son S, and the remaining 90% to his niece N. The son contested the will in a bona fide proceeding. On September 1, 1968, S and N executed an agreement whereby each received 50% of the estate. This settlement was then approved by the Probate Court which issued its decree of distribution in accordance therewith. The interests of S and N will be considered to have become indefeasibly fixed both in quality and quantity as of the date the order approving the settlement was made by the court.

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CHAPTER EIGHT: INH TAX 63-85

POWERS OF APPOINTMENT

Inh Tax 63 The provisions of this Regulation are applicable to all deaths occurring prior to April 11, 1963.

Inh Tax 64 General Rule. A power of appointment is the discretionary authority enabling the donee of such power to dispose of a beneficial interest in property which he does not own beneficially. A power of appointment may include either a general power or a special power. A general power is one under which the donee of the power can appoint to himself, his estate or his creditors. A special power is one under which the donee may appoint only among a restricted class of persons, not including himself, his estate or his creditors. This section is not applicable to a power of appointment retained by the transferor of property; for the taxation of retained powers see the regulations under subdivision 1 regarding transfers intended to take effect at death.

EXAMPLE 1: X conveys property to Y for life, with power in Y to appoint the remainder by will among Y's issue who survive Y and with remainder in default of appointment to Z. Y has a taxable special power of appointment.

EXAMPLE 2: X conveys property to Y for life, with power in Y to appoint the remainder to such person or persons, including Y's estate or Y's creditors, as Y may designate in his will, and with remainder in default of appointment to Z. Y has a taxable general power of appointment.

Inh Tax 65 The following powers are not powers of appointment within the meaning of this subdivision.

(a) A power which is held by the donee of the power in a fiduciary capacity if the donee's discretion in the exercise of such power is limited by an ascertainable standard.

EXAMPLE 1: X conveys property to Y in trust to pay the income therefrom to Z for life and to convey the principal to Z's surviving children upon Z's death, with power in Y to invade principal during Z's lifetime in order to provide for Z's maintenance in accordance with Z's accustomed standard of living. Since Y holds this power to invade principal in a fiduciary capacity and since the power is limited by an ascertainable standard (Z's maintenance in accordance with his accustomed standard of living), this power is not a power of appointment within the meaning of this subdivision.

EXAMPLE 2: X conveys property to Y in trust to pay the income therefrom to Z for life and to convey the principal to Z's surviving children upon Z's death, with power in Y to invade principal during Z's lifetime in Y's sole discretion. Assuming that Y's discretion is unlimited under Minnesota law (except by a requirement that he act in good faith), this power is a power of appointment within the meaning of this subdivision even though Y holds the power in a fiduciary capacity.

EXAMPLE 3: H bequeaths Blackacre to his wife W for life, with power in W to mortgage or sell Blackacre if it is necessary to use the proceeds for her support and maintenance, remainder upon W's death to H's brother B. Since W holds this power in a fiduciary capacity by virtue of her duty to

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the remainderman, (see **Beliveau v. Beliveau,** 217 Minn. 235 (1944)) and since the power is limited by an ascertainable standard, this power is not a power of appointment within the meaning of this subdivision.

(b) Any powers under a life insurance policy held by the insured or the beneficiary of the policy.

EXAMPLE 1: X is the owner of a life insurance policy which names Y as beneficiary. X has the right to change the beneficiary and the right to surrender the policy for its cash value. Upon the death of X, neither of these rights is taxable as a power of appointment. See, however, the regulations under subdivision five regarding the taxation of life insurance proceeds.

EXAMPLE 2: X is the insured owner of a life insurance policy which names Y as the beneficiary. X dies survived by Y and Y has the right to receive the proceeds of the policy in a lump sum, or to elect the settlement options provided for in the policy. Y elects to receive the proceeds of the policy in installments for life, with refund of the face amount of the policy guaranteed, and designates Z as the beneficiary of the refund feature, reserving the right to change the designation. Upon Y's death, survived by Z, Y's reserved right to change the designation is not taxable under this subdivision. See, however, the regulations under subdivision one regarding transfers intended to take effect at death.

(c) The right of an employee to designate the beneficiary of death benefits payable under any pension, profit sharing, stock bonus, annuity or other retirement plan. See, however, the regulations under subdivision one regarding transfers intended to take effect at death and M.S. § 291.065 of this chapter regarding death benefits under qualified retirement plans.

Inh Tax 66 An inheritance tax is imposed under this subdivision upon the transfer of property to the appointee through the exercise of the power by the donee, or upon the transfer to the taker in default upon the omission or failure of the donee to exercise the power. An inheritance tax is not imposed if the donee of the power makes a timely disclaimer or renunciation of the power. See the regulations under subdivision one regarding disclaimers and renunciations.

Inh Tax 67 A power of appointment shall be considered as exercised for purposes of this section even though the exercise is in favor of the taker in default of appointment and irrespective of whether the appointed interest is identical to the interest in default of appointment. A release or partial release of a power of appointment shall be considered an exercise of the power.

Inh Tax 68 The exercise or nonexercise of a power of appointment over intangible personal property by a resident decedent donee is a taxable transfer under this section even though the donor of the power was a nonresident.

Inh Tax 69 The fact that an inheritance tax may have been paid at the death of the donor of the power on the interest subject to the power does not preclude the imposition of an inheritance tax under this subdivision upon the exercise or nonexercise of the power by the donee. The tax imposed upon the exercise or non-exercise of the power shall be based upon the value of the property subject to the power at the death of the donee of the power. A refund payable to an appointee or taker in default of appoint-

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ment under M.S. § 291.11, subdivision five of this Chapter in respect of the tax imposed upon his interest in the property subject to the power at the death of the donor may be credited against the tax imposed upon him the exercise or non-exercise of the power by the donee.

EXAMPLE: H's will creates Trust A, a qualified federal estate tax marital deduction trust, for benefit of wife W. This trust is valued at $100,000. Trust B valued at $60,000 gives W income for life with a power to appoint principal among issue of H and W and with a gift in default of appointment to son S and daughter D equally. T, trustee, has discretionary power to invade the principal of trust B for benefit of W, S and D. At H's death, W is taxed as follows:

Trust A	$100,000.00	
Trust B (see M.S. § 291.11, Subd. 5)	60,000.00	
Total taxable	160,000.00	
Less exemption	30,000.00	
	130,000.00	
		Tax $4,400.00

During W's lifetime H has distributed $20,000 of Trust B to S and $15,000 to D. W, by will, appoints $15,000 of the remaining $25,000 to D and $10,000 to S. At the death of W the tax with respect to the estate of H is recomputed.

W, wife

Trust A	$100,000.00	
Trust B	25,000.00	
Total taxable	125,000.00	
Less exemption	30,000.00	
	95,000.00	
		Tax $2,900.00

S, son

Trust B	$ 20,000.00	
Less exemption	6,000.00	
	14,000.00	
		Tax $ 280.00

D, Daughter

Trust B	$ 15,000.00	
Less exemption	6,000.00	
Taxable	9,000.00	
		Tax $ 180.00
		Total tax $3,360.00

Refund due—$1,040.00 plus accrued interest at 3%.

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Inh Tax 70 The provisions of this regulation are applicable to all deaths occurring after April 10th, 1963.

Inh Tax 71 Introduction. A taxable transfer under the provisions of this Chapter shall be deemed to have been made to the extent of any property with respect to which the decedent had possessed, exercised, or released certain powers of appointment.

Inh Tax 72 Definition of "power of appointment."

(a) In general. The term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment. However, the decedent is not considered to have a power of appointment if he only had the power to appoint a successor, including himself, under limited conditions which did not exist at the time of his death, without an accompanying unrestricted power of removal. Similarly, a power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the beneficial enjoyment of the trust property or income is not a power of appointment. The mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment. Further, the right in a beneficiary of a trust to assent to a periodic accounting, thereby relieving the trustee from further accountability, is not a power of appointment if the right of assent does not consist of any power or right to enlarge or shift the beneficial interest of any beneficiary therein.

(b) Relation to other sections. For purposes of this regulation, the term "power of appointment" does not include powers reserved by the decedent to himself within the concept of M.S. § 291.01, Subd. 1 (3). No provision of M.S. § 291.01, Subd. 3 or of this regulation is to be construed as in any way limiting the application of any other section of M.S. Chapter 291 or the regulations applicable thereto. The power of the owner of a property interest already possessed by him to dispose of his interest, and nothing more, is not a power of appointment, and the interest is includible in his estate to the extent it would be includible under M.S. §291.01, Subds. 1 or 2. For example, if a trust created by S provides for payment of the income to A for life with power in A to appoint the remainder by will and, in default of such appointment for payment of the income to A's widow, W, for her life and for payment of the remainder to A's estate, the value of A's interest in the remainder is includible in his estate under M.S. § 291.01, Subds. 1 and 2, regardless of its includability under M.S. § 291.01, Subd. 3.

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(c) Powers over a portion of property. If a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, M.S. § 291.01, Subd. 3 applies only to such part or interest. For example, if a trust created by S provides for the payment of income to A for life, then to W for life, with power in A to appoint the remainder by will and in default of appointment for payment of the remainder to B or his estate, and if A dies before W, M.S. § 291.01, Subd. 3 applies only to the value of the remainder interest excluding W's life estate. If A dies after W, M.S. § 291.01, Subd. 3 would apply to the value of the entire property. If the power were only over one-half the remainder interest, M.S. § 291.01, Subd. 3 would apply only to one-half the value of the amounts described above.

Inh Tax 73 Definition of "general power of appointment."

(a) In general. The definition of "general power of appointment" as defined in M.S. § 291.01, Subd. 3 (3) means any power of appointment exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except (1) joint powers, to the extent provided in this regulation, and (2) certain powers limited by an ascertainable standard, to the extent provided in subparagraph (b) of this paragraph. A power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the estate, is included within the meaning of a power of appointment exercisable in favor of the decedent's estate, his creditors, or the creditors of his estate. A power of appointment exercisable for the purpose of discharging a legal obligation of the decedent or for his pecuniary benefit is considered a power of appointment exercisable in favor of the decedent or his creditors. However, for purposes of this regulation, a power of appointment not otherwise considered to be a general power of appointment is not treated as a general power of appointment merely by reason of the fact that an appointee may, in fact, be a creditor of the decedent or his estate. A power of appointment is not a general power if by its terms it is either—

(1) Exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or

(2) Expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate or the creditors of his estate.

A decedent may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a power to withdraw trust corpus during his life, and a testamentary power to appoint the corpus among his descendants. The testamentary power is not a general power of appointment.

(b) Powers limited by an ascertainable standard. A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of M.S. § 291.01, Subd. 3 (3) (a), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are

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synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support", "support in reasonable comfort", "maintenance in health and reasonable comfort", "support in his accustomed manner of living", "education, including college and professional education", "health", and "medical, dental, hospital and nursing expenses and expenses of invalidism". In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Inh Tax 74 Definition of "exercise". The residuary clause of a will may be considered as an exercise of a testamentary power of appointment in the absence of evidence of a contrary intention drawn from the whole of the testator's will. However, a power of appointment is considered as exercised for purposes of M.S. § 291.01, Subd. 3 even though the exercise is in favor of the taker in default of appointment, and irrespective of whether the appointed interest and the interest are in default of appointment are identical or whether the appointee renounces any right to take under the appointment. A power of appointment is also considered as exercised even though the disposition cannot take effect until the occurrence of an event after the exercise takes place, if the exercise is irrevocable and, as of the time of the exercise, the condition was not impossible of occurrence. For example, if property is left in trust to A for life, with a power in B to appoint the remainder by will, and B dies before A, exercising his power by appointing the remainder to C if C survives A, B is considered to have exercised his power if C is living at B's death. On the other hand a testamentary power of appointment is not considered as exercised if it is exercised subject to the occurrence during the decedent's life of an express or implied condition which did not in fact occur. Thus, if in the preceding example, C dies before B, B's power of appointment would not be considered to have been exercised. Similarly, if a trust provides for income to A for life, remainder as A appoints by will, and A appoints a life estate in the property to B and does not otherwise exercise his power, but B dies before A, A's power is not considered to have been exercised.

Inh Tax 75 Existence of power at death. For purposes of M.S. § 291.01, Subd. 3 (1), a power of appointment is considered to exist on the date of a decedent's death even though the exercise of the power is subject to the precedent giving of notice, or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the decedent's death notice has been given or the power has been exercised. However, a power which by its terms is exercisable only upon the occurrence during the decedent's lifetime of an event or a contingency which did not in fact take place or occur during such time is not a power in existence on the date of the decedent's death. For example, if a decedent was given a general power of appointment exercisable only after he reached a certain age, only if he survived another person, or only if he died without descendants, the power would not be in existence on the date of the decedent's death if the condition precedent to its exercise had not occurred.

Inh Tax 76 Joint Powers. The treatment of a power of appointment which is exercisable only in conjunction with another person is governed by M.S. § 291.01, Subd. 3 (3) (b) (A) and (B), which provide as follows:

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(a) Such a power is not considered a general power of appointment if it is not exercisable by the decedent except with the consent or joinder of the creator of the power.

(b) Such power is not considered a general power of appointment if it is not exercisable by the decedent except with the consent or joinder of a person having a substantial interest in the property subject to the power which is adverse to the exercise of the power in favor of the decedent, his estate, his creditors, or the creditors of his estate. An interest adverse to the exercise of a power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. For this purpose, the interest is to be valued in accordance with the actuarial principles set forth in federal regulations or, if it is not susceptible to valuation under those provisions, in accordance with the general principles set forth in these regulations. A taker in default of appointment under a power has an interest which is adverse to an exercise of the power. A coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the decedent's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. Thus, for example, if X, Y and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y. The application of this subparagraph may be further illustrated by the following additional examples in each of which it is assumed that the value of the interest in question is substantial:

EXAMPLE 1: The decedent and R were trustees of a trust under the terms of which the income was to be paid to the decedent for life and then to M for life, and the remainder was to be paid to R. The trustees had power to distribute corpus to the decedent. Since R's interest was substantially adverse to an exercise of the power in favor of the decedent, the latter did not have a general power of appointment. If M and the decedent were the trustees, M's interest would likewise have been adverse.

EXAMPLE 2: The decedent and L were trustees of a trust under the terms of which the income was to be paid to L for life and then to M for life, and the remainder was to be paid to the decedent. The trustees had power to distribute corpus to the decedent during L's life. Since L's interest was adverse to an exercise of the power in favor of the decedent, the decedent did not have a general power of appointment. If the decedent and M were the trustees, M's interest would likewise have been adverse.

EXAMPLE 3: The decedent and L were trustees of a trust under the terms of which the income was to be paid to L for life. The trustees could designate whether corpus was to be distributed to the decedent or to A after L's death. L's interest was not adverse to an exercise of the power in favor of the decedent, and the decedent therefore had a general power of appointment.

(c) A power which is exercisable only in conjunction with another person, and which after application of the rules set forth in subparagraphs (a) and

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(b) of this paragraph constitutes a general power of appointment, will be treated as though the holders of the power who are permissible appointees of the property were joint owners of property subject to the power. The decedent, under this rule, will be treated as possessed of a general power of appointment over an aliquot share of the property to be determined with reference to the number of joint holders, including the decedent, who (or whose estates or creditors) are permissible appointees.

Inh Tax 77 Releases, lapses, and disclaimers of general powers of appointment.

(a) Property subject to a general power of appointment is includible in the taxable estate of a decedent under M.S. § 291.03 even though he does not have the power at the date of his death, if during his life he exercised or released the power under circumstances such that, if the property subject to the power had been owned and transferred by the decedent, the property would be includible in the decedent's taxable estate under M.S. § 291.01, Subd. 1 (3). Further, M.S. § 291.01, Subd. 3 (4) provides that the lapse of a power of appointment is considered to be a release of the power to the extent set forth in subparagraph (3) of this paragraph. A release of a power of appointment need not be formal or express in character.

(b) The complete release of a general power of appointment whether exercisable during life or by will, will not be deemed taxable under the provisions of Chapter 291, if the release was not made in contemplation of death within the meaning of M.S. § 291.01, Subd. 1(3), and if after the release the holder of the power retained no interest in or control over the property subject to the power which would cause the property to be included in his taxable estate under M.S. § 291.01, Subd. 1(3), if the property had been transferred by the holder.

(c) The failure to exercise a power of appointment within a specified time, so that the power lapses, constitutes a release of the power. However, such a lapse of a power of appointment during any calendar year during the decedent's life is treated as a release for purposes of inclusion of property in the taxable estate under M.S. § 291.01, Subd. 3(4) only to the extent that the property which could have been appointed by exercise of the lapsed power exceeds the greater of (1) $5,000 or (2) 5 percent of the aggregate value, at the time of the lapse of the assets out of which, or the proceeds of which, the exercise of the lapsed power could have been satisfied. For example, assume that A transferred $200,000 worth of securities in trust providing for payment of income to B for life with remainder to B's issue. Assume further that B was given a noncumulative right to withdraw $10,000 a year from the principal of the trust fund (which neither increased nor decreased in value prior to B's death). In such case, the failure of B to exercise his right of withdrawal will not result in inheritance tax with respect to the power to withdraw $10,000 which lapses each year before the year of B's death. At B's death there will be included in his taxable estate the $10,000 which he was entitled to withdraw for the year in which his death occurs less any amount which he may have taken during that year. However, if in the above example B had possessed the right to withdraw $15,000 of the principal annually, the failure to exercise such power in any year will be considered a release of the power to the extent of the excess of the amount subject to withdrawal over 5 percent of the trust fund (in this example, $5,000, assuming that the trust fund is worth $200,000 at the time of the lapse). Since each lapse

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is treated as though B had exercised dominion over the trust property by making a transfer of principal reserving the income therefrom for his life, the value of the trust property (but only to the extent of the excess of the amount subject to withdrawal over 5 percent of the trust fund) is includible in B's taxable estate (unless before B's death he has disposed of his right to the income under circumstances to which M.S. § 291.01, Subd. 1(3) would not be applicable). The extent to which the value of the trust property is included in the decedent's taxable estate is determined as provided in subparagraph (d) of this paragraph.

(d) The purpose of M.S. § 291.01, Subd. 3(4) is to provide a determination, as of the date of the lapse of the power, of the proportion of the property over which the power lapsed which is an exempt disposition for inheritance tax purposes and the proportion which, if the other requirements of M.S. § 291.01, Subd. 1(3) are satisfied, will be considered as a taxable disposition. Once the taxable proportion of any disposition at the date of lapse has been determined, the valuation of that proportion as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under M.S. § 291.23, the value as of the date therein provided, if applicable) is to be ascertained in accordance with the principles which are applicable to the valuation of transfers of property by the decedent under the corresponding provisions of M.S. § 291.01, Subd. 1(3). For example, if the life beneficiary of a trust had a right exercisable only during one calendar year to draw down $50,000 from the corpus of a trust, which he did not exercise, and if at the end of the year the corpus was worth $800,000, the taxable portion over which the power lapsed is $10,000 (the excess of $50,000 over 5 percent of the corpus), or 1/80 of the total value. On the decedent's death, if the total value of the corpus of the trust (excluding income accumulated after the lapse of the power) on the applicable valuation date was $1,200,000, $15,000 (1/80 of $1,200,000) would be includible in the decedent's taxable estate. However, if the total value was then $600,000, only $7,500 (1/80 of $600,000) would be includible.

(e) If the failure to exercise a power, such as the right of withdrawal, occurs in more than a single year, the proportion of the property over which the power lapsed which is treated as a taxable disposition will be determined separately for each such year. The aggregate of the taxable proportions for all such years, valued in accordance with the above principles, will be includible in the taxable estate by reason of the lapse. The includible amount, however, shall not exceed the aggregate value of the assets out of which, or the proceeds of which, the exercise of the power could have been satisfied, valued as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under M.S. § 291.23, the value as of the date therein provided, if applicable).

(f) A disclaimer or renunciation of a general power of appointment is not considered to be a release of the power. The disclaimer or renunciation must be unequivocal and effective. A disclaimer is a complete and unqualified refusal to accept the rights to which one is entitled. There can be no disclaimer or renunciation of a power after its acceptance. In any case where a power is purported to be disclaimed or renounced as to only a portion of the property subject to the power, the determination as to whether or not there has been a complete and unqualified refusal to accept the rights to which one is entitled will depend on all the facts and circumstances of the particular case, taking into account the recognition and effectiveness of such a disclaimer under law. Such rights refer to the in-

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cidents of the power and not to other interests of the decedent in the property. If effective under law, the power may be disclaimed or renounced without disclaiming or renouncing such other interests. In the absence of facts to the contrary, the failure to renounce or disclaim within a reasonable time after learning of its existence will be presumed to constitute an acceptance of the power.

Inh Tax 78 Successive powers.

(a) Property subject to a power of appointment which is not a general power, is includible in the taxable estate of the holder of the power under M.S. § 291.01, Subd. 3(2) if the power is exercised, and if both of the following conditions are met:

(1) If the exercise is (aa) by will, or (bb) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's taxable estate under M.S. § 291.01, Subd. 1(3); and

(2) If the power is exercised by creating another power of appointment which, under the terms of the instruments creating and exercising the first power and under applicable Minnesota law, can be validly exercised so as to (aa) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of the creation of the first power, or (bb) (if the applicable Minnesota rule against perpetuities is stated in terms of suspension of ownership or the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

(b) For purposes of the application of M.S. § 291.01, Subd. 3(2), the value of the property subject to the second power of appointment is considered to be its value unreduced by any precedent or subsequent interest which is not subject to the second power. Thus, if a decedent has a power to appoint by will $100,000 to a group of persons consisting of his children and grandchildren and exercises the power by making an outright appointment of $75,000 and by giving one appointee a power to appoint $25,000, no more than $25,000 will be includible in the decedent's taxable estate under M.S. § 291.01, Subd. 3(2). If, however, the decedent appoints the income from the entire fund to a beneficiary for life with power in the beneficiary to appoint the remainder by will, the entire $100,000 will be includible in the decedent's taxable estate under M.S. § 291.01, Subd. 3(2) if the exercise of the second power can validly postpone the vesting of any estate or interest in the property or can suspend the absolute ownership or power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

Inh Tax 79 Examples. The application of this section may be further illustrated by the following examples, in each of which S has transferred property in trust with the remainder payable to R at L's death, and that neither L nor R has any interest in or power over the enjoyment of the trust property except as is indicated separately in each example:

EXAMPLE 1: Income is directed to be paid to L during his lifetime at the end of each year, if living. L has an unrestricted power during his lifetime to cause the income to be distributed to any other person, but no power to cause it to be accumulated. At L's death, no part of the trust

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property is includible in L's taxable estate since L had a power to dispose of only his income interest, a right otherwise possessed by him.

EXAMPLE 2: Income is directed to be accumulated during L's life but L has a noncumulative power to distribute $10,000 of each year's income to himself. Unless L's power is limited by an ascertainable standard (relating to his health, etc.), as defined in this regulation, he has a general power of appointment over $10,000 of each year's income, the lapse of which may cause a portion of any income not distributed to be included in his taxable estate under M.S. § 291.01, Subd. 3. See subparagraph c of Inh. Tax 77. Thus, if the trust income during the year amounts to $20,000, L's failure to distribute any of the income to himself constitutes a lapse as to $5,000 (i.e., the amount by which $10,000 exceeds $5,000). If L's power were cumulative (i.e., if the power did not lapse at the end of each year but lapsed only by reason of L's death), the total accumulations which L chose not to distribute to himself immediately before his death would be includible in his taxable estate under M.S. § 291.01, Subd. 3.

EXAMPLE 3: L is entitled to all the income during his lifetime and has an unrestricted power to cause corpus to be distributed to himself. L had a general power of appointment over the corpus of the trust, and the entire corpus as of the time of his death is includible in his taxable estate under M.S. § 291.01, Subd. 3.

EXAMPLE 4: Income was payable to L during his lifetime. R has an unrestricted power to cause corpus to be distributed to L. R dies before L. In such case, R has only a power to dispose of his remainder interest, the value of which is includible in his estate under M.S. § 291.01, Subd. 1, and nothing in addition would be includible under M.S. § 291.01, Subd. 3. If in this example R's remainder were contingent on his surviving L, nothing would be includible in his taxable estate under either M.S. § 291.01, Subds. 1 or 3. While R would have a power of appointment, it would not be a general power.

EXAMPLE 5: Income was payable to L during his lifetime. R has an unrestricted power to cause corpus to be distributed to himself. R dies before L. While the value of R's remainder interest is includible in his taxable estate under M.S. § 291.01, Subd. 1, R also has a general power of appointment over the entire trust corpus. Under such circumstances, the entire value of the trust corpus is includible in R's taxable estate under M.S. § 291.01, Subd. 3.

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CHAPTER NINE: INH TAX 86-93

JOINTLY OWNED PROPERTY

Inh Tax 86 In general. Whenever any property, real or personal, is held in the joint names of two or more persons with right of survivorship and one of the joint owners dies, this subdivision treats such property as if owned absolutely by the decedent, and treats the right of any survivor to immediate ownership, possession, and enjoyment of such property as a transfer which subjects the full value of the jointly owned property to the inheritance tax. The "transfer" of that portion of the jointly owned property which originally belonged to any survivor and was never received or acquired by any survivor from the decedent for less than adequate and full consideration in money or money's worth, however, is **not** subject to the tax. Also, where any survivor furnished consideration for his interest in the jointly owned property, he may except from its value, in determining his tax, an amount proportionate to that consideration. There are two exceptions to this general method of taxing jointly owned property.

(a) Where the legal title to any property has been acquired by the decedent and spouse as joint tenants prior to April 29, 1935, no more than one half of the value of such property shall be taxable. In such a case, where more than one half of the jointly owned property originally belonged to the surviving spouse, or where the surviving spouse furnished more than one half of the consideration for said property, the amount taxable to the survivor shall be proportionately reduced. This first exception applies to joint tenancies in both real and personal property but not to joint and several bank accounts under M.S. § 48.30.

(b) Where any property has been acquired by gift, bequest, devise, or inheritance by the decedent and any other person or persons, as joint tenants, the tax imposed is not computed on the full value of such property; instead, the taxable portion is the decedent's fractional share of said property, which is determined by dividing the value of the property by the number of joint tenants. This second exception applies to joint tenancies in both real and personal property, and to joint and several bank accounts as defined under M.S. § 48.30.

Inh Tax 87 Application of Subdivision.

(a) "Transfer". The term "transfer" is defined in the regulations under the first paragraph of M.S. § 291.01 (1).

(b) "Jointly Owned Property." M.S. § 291.01 (4) specifically covers property held jointly by the decedent and any other persons and a deposit of money in the name of the decedent and any other persons and payable to either or the survivor. This subdivision applies to all classes of property whether real or personal. It is immaterial that the survivor takes the entire interest in the property by right of survivorship and that no interest therein forms a part of the decedent's estate for purposes of administration. This subdivision has no application to property held by the decedent and any other persons as tenants in common.

EXAMPLE A: At A's death, 100 shares X Company stock was registered in the joint names of A and B. This represents a transfer subject to the provisions of this subdivision.

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EXAMPLE B: A United States Savings Bond, Series E, with a face value of $1,000 was registered in the names of A or B. At the death of A this represents a transfer subject to the provisions of this subdivision.

EXAMPLE C: At the death of A, there was on deposit at the Z Savings and Loan Association $10,000, in the names of A and B. This represents a transfer subject to the provisions of this subdivision.

(c) "Burden of Proof." The survivor has the burden of proving that the full value of the jointly owned property should not be subject to the inheritance tax by affirmatively showing that the decedent did not pay the full consideration for the property, that the property originally belonged to the survivor, that the property was acquired in joint tenancy by gift, bequest, devise, or inheritance, or that the property was acquired by the decedent and the survivor as husband an wife in joint tenancy prior to April 29, 1935. The Commissioner requires an affidavit stating the proportion contributed by the survivor. The Commissioner may require that such affidavit be supported by such supplemental information as bills of sale, receipts, cancelled checks, bank books, copy showing withdrawals for purchases, personal record books, copy of decrees of distribution where survivor's contribution was inherited, and copies of survivor's and decedent's income tax returns. Such income tax returns shall be provided by the taxpayer, or in the alternative the taxpayer may authorize the examination of income tax returns filed with the department. When the survivor has satisfied the burden of proving that he contributed some consideration, but is unable to establish the amount of the contribution, the Commissioner shall determine the amount from the information available.

(d) "Originally belonged to Survivor." A surviving owner of jointly owned property is not subject to an inheritance tax on that portion of such property which originally belonged to him. To benefit from this exception, the survivor must trace the cost of the jointly owned property to consideration furnished by him.

EXAMPLE 1: In 1961, H gave his wife, W, Whiteacre, then valued at $20,000, and fifty shares of X corporation stock which were then selling at $100 per share. In 1963 W sold Whiteacre for $25,000. In 1964 W received a stock dividend of three shares from X corporation and sold them for $75.00 per share, or $225. In 1965, W sold all her X corporation stock for $120 per share, or $6,000. During the five years W held the X stock she received cash dividends of $100 per year, a total of $500. H and W then purchased Blackacre in joint tenancy; they contributed equally to the purchase price of $70,000. W's contribution consisted of the following: proceeds from the sale of Whiteacre ($25,000), cash dividends from X corporation stock ($500), proceeds from the sale of X stock received as a stock dividend ($225), proceeds from the sale of the rest of the X stock ($6,000), and $3,275 inherited from her grandfather. H's contribution consisted solely of cash originally owned by him. Should H die, survived by W, while Blackacre is still valued at $70,000, W will be allowed to exclude $10,000 in computing her inheritance tax on the "transfer" of H's interest in Blackacre; this amount is considered to have belonged originally to her and not to have been acquired from H for less than adequate consideration. (1) When W sold Whiteacre for $25,000 she made a profit of $5,000 which she is allowed to exclude. (2) W may exclude the $500 which represents her total cash dividends from X corporation. (3) W may also exclude the entire proceeds from the sale of stock received as a stock

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dividend. (4) W made a profit of $20 per share when she sold the original fifty shares of X stock for $6,000. This profit is excludable but the remainder of the sale price, or $5,000, which represents the original cost of these shares, must be included when determining W's tax. (5) W's inheritance of $3,275 from her grandfather may be excluded.

EXAMPLE 2: A and B contributed equally to the purchase of Blackacre from X who conveyed the property to A and C in joint tenancy. If A dies, survived by C, C will be liable for an inheritance tax based on one half of the value of Blackacre. C's acquisition of the share of Blackacre attributable to B's contribution may be subject to the gift tax, but since this share was not received from A, it "originally belonged" to C with respect to A and is not taxable under this chapter.

(e) "Adequate and Full Consideration in Money or Money's Worth." This phrase is interpreted generally in the regulations under M.S. § 291.01, Subds. 1, 2 and 3. The following material, consisting almost entirely of examples, is intended to clarify some consideration problems peculiar to the jointly owned property subdivision.

(1) Consideration furnished by the survivor(s).

EXAMPLE 1: A and B purchased Blackacre in joint tenancy; A furnished the entire consideration. A dies survived by B. B's inheritance tax will be computed on the full value of Blackacre. If B were to die survived by A and A were unable to support his claim that he had furnished the entire consideration for Blackacre, A would also be taxed on its full value. If A proves that he furnished the entire consideration for Blackacre, the transfer will be tax free.

EXAMPLE 2: A and B purchased Blackacre in joint tenancy for $10,000. A contributed $7,500 to the purchase price, while B contributed $2,500. When A died, survived by B, Blackacre was worth $20,000. In computing B's inheritance tax, $5,000 will be excepted as his consideration allowance; the tax will be based on $15,000. Since B contributed 25% of the cost of Blackacre, he is entitled to a 25% deduction from Blackacre's value at A's death, or $5,000. The same result would be reached if Blackacre originally cost $7,500, which was furnished entirely by A, and B then contributed capital improvements which cost $2,500.

(2) Services as consideration.

EXAMPLE: H and W, his wife, contributed equally to establish a retail grocery business; they agreed to cooperate in its management and development and to share its profits equally. Profits were used to purchase Redacre in joint tenancy. If H dies, survived by W, W may exclude one half of the value of the jointly owned property in computing her inheritance tax. The prior agreement to share the profits equally is essential to the establishment of W's claim; it negates the possible inference that she intended to render her services gratuitously or in discharge of her marital obligations. The existence of such an agreement must be clearly established. Since W furnished one half of the purchase price for the jointly held property, one half of its present value will be excluded in computing her inheritance tax.

(f) Property acquired in Joint Tenancy by Husband and Wife Prior to April 29, 1935.

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EXAMPLE 1: H and his wife W purchased Blackacre in joint tenancy in 1930. H furnished all the consideration. If H dies survived by W, W will be liable for an inheritance tax based on one half of the value of Blackacre. If W had contributed two-thirds of the consideration, she would be liable for an inheritance tax based on only one-third the value of Blackacre.

EXAMPLE 2: In 1933, a mortgage on Blackacre was executed to H and his wife W as joint tenants. H furnished the entire consideration. In 1944 the mortgage was foreclosed and the mortgagor conveyed Blackacre to H and W as joint tenants. If H dies, survived by W, W's inheritance tax will be computed on the full value of Blackacre. Since H and W's legal interest in Blackacre was created after April 29, 1935, the proviso in the second sentence of this subdivision is inapplicable.

(g) Property Acquired in Joint Tenancy by Gift, Bequest, Devise, or Inheritance.

EXAMPLE: A, B, C, and D inherited Blackacre from X as joint tenants. In computing the inheritance tax due upon the death of A, when Blackacre was worth $12,000, A's one-fourth interest will be divided equally among the survivors, hence each survivor will be taxed upon one-twelfth of the value of Blackacre ($1,000). In computing the inheritance tax due upon B's subsequent death, survived by C and D, with the property valued at $24,000, C and D are each considered to have contributed one-fourth of the original consideration plus the one-twelfth taxed to each upon the prior death of A. Therefore, C and D each contributed one-third of the consideration for Blackacre, and each will be taxable on one-half of the remaining third received from B, or $4,000.

If C dies survived by D, and the value of Blackacre has fallen to $18,000, D is taxable on $9,000, computed by taking the value of the property ($18,000) and deducting the contributions of D. D is considered to have contributed the one-fourth originally inherited by him from X, plus the one-twelfth taxed to him upon the death of A, plus the one-sixth taxed to him upon the death of B, or a total of one-half the value of Blackacre.

Inh Tax 88 Three or More Joint Tenants.

(a) In cases in which the entire consideration was contributed by the several joint tenants, the amount taxable to a surviving joint tenant upon the death of a joint tenant, shall be determined by the percentage of value contributed by the survivors.

(b) Upon the death of any joint tenant, the survivors are taxable on the value of the property, minus that percentage of such value which equals the percentage of consideration furnished by the survivors.

(c) In addition to the consideration furnished personally by a survivor, a survivor is deemed to have furnished an amount equal to that percentage of such value previously taxed to the survivor.

EXAMPLE: F (father), M (mother) and C (child) are joint tenants of property for which F contributed $4,000, M contributed $2,000, and C contributed nothing.

(1) If C dies survived by F and M, at which time the property is valued at $9,000, F and M are not taxable.

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(2) If the joint tenancy continues between F and M until the death of M and the value of the property on M's death is $12,000, $4,000 will be taxable to F, representing the percentage of the value of the property on the death of M attributable to M's contribution (i.e. $2,000 × $12,000 = $6,000 $4,000).

(3) If, instead, F is the first joint tenant to die, being survived by M and C when the property is valued at $12,000, the amount taxable to M and C is determined as follows:

M and C are taxable on $8,000, representing the percentage of the value of the property on the death of F attributable to F's contribution (i.e. $4,000 × $12,000 = $8,000). Of this amount, C is taxable on the $6,000 value of his interest ($6,000) less the amount attributable to his contribution (zero), or $6,000. M is taxable on the value of her interest ($6,000) less the amount attributable to her contribution ($4,000), or $2,000.

(4) If the joint tenancy continues until the death of M at which time the property is still valued at $12,000, C is taxable on another $6,000, representing the value of the property on the date of death ($12,000) less C's contribution (0%) and the amount of F's proportionate contribution taxable to C on the death of F ($6,000).

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CHAPTER TEN: INH TAX 94-110

INSURANCE PROCEEDS

Inh Tax 94 The taxation of life insurance proceeds payable upon the death of decedents dying prior to April 6, 1963 is subject to the following Regulations:

Inh Tax 95 Insurance Payable to the Estate of the Insured.

Where the proceeds of life insurance are payable on the death of the insured to his estate, administrator, or executor, or are receivable by trustees, such proceeds are taxable under M.S. § 291.01, Subd. 1 as follows:

(a) Such proceeds payable to intervivos or testamentary trustees who are under a legal obligation to use the funds to satisfy debts, expenses, and taxes which are legally enforceable against the insured's estate are taxable under M.S. § 291.01, Subd. 1 to the extent of such obligation, regardless of whether so used.

(b) Proceeds payable to intervivos or testamentary trustees who have discretionary power to satisfy debts, expenses, and taxes of the insured's estate are taxable under M.S. § 291.01, Subd. 1, only to the extent such proceeds are actually used for any such purpose.

Insurance proceeds payable to a named beneficiary in satisfaction of an obligation of the insured shall not be taxable under this Chapter to the extent of such obligation.

EXAMPLE: Decedent's Personal Loan from Bank secured by Life Insurance.

A borrows $15,000 from B, for five years and assigns a policy of life insurance in the face amount of $15,000 to C, in escrow as security for the loan, designating B as beneficiary. A dies and B receives the insurance proceeds in repayment of the principal of the loan. B is not taxable on such proceeds under this subdivision.

Inh Tax 96 Insurance Payable to "Named Beneficiaries".

Life insurance proceeds payable by reason of death to named beneficiaries are taxable under M.S. § 291.01, Subd. 5. A "named beneficiary" for purposes of this subdivision is the natural or legal person (excluding the decedent's estate or personal representative) designated in the life insurance contract on the date of death of the decedent-insured as entitled to receive the proceeds thereof.

The provisions of this paragraph may be illustrated by the following example:

EXAMPLE: The proceeds of an insurance policy are payable to X, the beneficiary designated on the face of the policy, upon the death of Y, the insured. X received the proceeds from the insurance company but paid the money to Z, under the terms of a trust created for the benefit of Z. X is the "named beneficiary" even though legally bound to pay the proceeds to another under the trust. However, under this Chapter, the proceeds will be taxed as a transfer to Z.

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Inh Tax 97 Life and Accident Insurance Defined.

For purposes of this subdivision, except as otherwise provided in this paragraph, "life insurance" is defined as any contract which at the time of the decedent's death wholly or partially shifts to a group of individuals the risk of premature death of one of its members. The term "accident insurance" means life insurance payable by reason of accidental death. For purposes of this subdivision, the term "life insurance" does not include a payment receivable by a named beneficiary under a pension, stock bonus, profit-sharing, or retirement plan meeting the requirements of M.S. § 291.065, whether or not the payment represents the proceeds of life insurance under the definition set forth in the preceding provisions of this paragraph.

Inh Tax 98 Annuity Contracts

Annuity contracts are not insurance within the meaning of M.S. § 291.01, Subd. 5. An annuity contract providing for a refund of all or a part of premiums paid in the event of death prior to the date of commencement of the annuity payments, is not an insurance contract within the meaning of this subdivision whether the refund is payable to the decedent's estate or to a named beneficiary.

Inh Tax 99 Endowment Contracts.

Whether an endowment contract is taxable under M.S. § 291.01, Subd. 5 is determined by the relation of the reserve value of the policy to the value of the death benefit at the time of the decedent's death. If the decedent dies before the reserve value of the contract equals the death benefit, the contract contains an element of life insurance and the entire proceeds are taxable under the provisions of M.S. § 291.01, Subd. 5. If the decedent dies after the reserve value equals the death benefit, the life insurance element is no longer present and the benefits are not taxable as life insurance proceeds, but see Section 291.01, Subdivision 1, and the regulations thereunder which may render such benefits taxable.

Inh. Tax 100 Single Premium Life Insurance Policies Taken Out with Annuity Contracts

A "single premium life insurance policy" providing for the payment of a death benefit, taken out concurrently with an annuity contract, entitling the purchaser to annuity benefits, is not "insurance" within the meaning of M.S. § 291.01, Subd. 5, if it is established that the life insurance policy would not have been issued without the annuity contract. For purposes of this paragraph, a "single premium life insurance policy" includes a policy which is fully paid-up within one year after issuance. This rule is applicable whether or not the decedent held incidents of ownership in the life insurance portion of the combination plan at or after the issuance thereof.

EXAMPLE: In 1957, decedent purchased an annuity contract for $22,000 providing for payments of $1,600 annually until his death. He also purchased an insurance policy with a $72,000 face value for a single premium of $53,000. The life insurance policy would not have been issued had the decedent not also purchased the annuity contract. In 1958, the decedent irrevocably assigned all incidents of ownership in the life insurance policy to his son S. M.S. § 291.01, Subd. 5 has no application to contracts which, taken as a whole, do not require the issuer to assume life

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insurance risk. The $72,000 payable to S upon the decedent's death is taxable, if at all, under M.S. § 291.01, Subd. 1.

Inh Tax 101 Definition of "Taken out by Decedent"

Life insurance proceeds payable by reason of death to "named beneficiaries" are subject to taxation under M.S. § 291.01, Subd. 5 only if the policy was "taken out by decedent."

The term "taken out by decedent" requires something further than the mere signature of decedent to an application for an insurance policy. In addition, decedent during his lifetime must have acquired some beneficial right or interest in policy; or undertaken some obligation or duty with respect thereto which would have caused all or some part of the proceeds thereof to come into existence upon his death.

Life insurance is "taken out by decedent" if the decedent-insured has ever held an incident of ownership in the life insurance contract. Common incidents of ownership include (a) the power to change the beneficiary; (b) the power to surrender or cancel the policy for cash; (c) the power to assign the policy; (d) the power to revoke an assignment; (e) the power to pledge the policy for a loan; (f) the power to obtain a loan from the insurer secured by the cash surrender value of the policy; (g) the power to change the beneficial ownership; (h) the power to change the beneficiary reserved to a corporation in which the decedent-insured is the sole shareholder.

A life insurance policy is not "taken out by decedent" merely because the decedent-insured pays part or all of the premiums.

EXAMPLE: W signed an application for a policy insuring the life of her husband H. H submitted to necessary medical examinations. The policy was issued to W as holder of all incidents of ownership. H paid all premiums but at no time held an incident of ownership in the policy. Upon H's death the proceeds are not subject to taxation under this subdivision because the policy was not "taken out by decedent".

Inh Tax 102 Taxation of Life Insurance "Taken out by Decedent" and Payable to "Named Beneficiaries."

(a) The proceeds of life insurance policies "taken out by decedent" and payable to "named beneficiaries" issued on or after April 25, 1949 are taxable in all cases.

(b) The proceeds of life insurance policies issued prior to April 25, 1949, "taken out by decedent" and payable to "named beneficiaries" are taxable if the decedent-insured held either the right to change the beneficiary or the right to surrender the policy for cash at any time on or after April 25, 1949.

EXAMPLE 1: A purchased life insurance policy in 1944. In 1948, A irrevocably assigned the policy to B. A continued to pay the premiums. Upon A's death in 1962, no inheritance tax is due under this subdivision.

EXAMPLE 2: In 1955, H irrevocably assigned life insurance policies of the face amount of $50,000 to his wife W. H paid Federal and Minnesota gift taxes upon a valuation of $26,000, representing the replacement cost of the policies. H paid all premiums subsequent to the assignment. Upon H's death in 1962, the entire $50,000 proceeds are subject to the inheritance tax under this subdivision.

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EXAMPLE 3: In 1956, X corporation applied for and was issued a group life insurance policy covering the lives of its employees. The contract gave each employee the right to designate and change the designation of beneficiaries. Employee A designated his son S as beneficiary, retaining the right to change the designation until his death in 1962. The proceeds of the insurance on A's life are taxable under this subdivision.

Inh Tax 103 Full or Partial Consideration.

(a) Life insurance proceeds are not taxable under M.S. § 291.01, Subd. 5 if the decedent-insured transfers all incidents of ownership in the insurance contract to an assignee for full and adequate consideration in money or money's worth in an arms length business transaction and such assignee (or his successor in interest other than the decedent-insured's estate) receives the proceeds of the policy.

(b) An amount of life insurance proceeds equal to the consideration is exempt if the decedent-insured transfers all incidents of ownership to an assignee for less than full and adequate consideration in money or money's worth and such assignee receives the proceeds.

(c) An amount of life insurance proceeds equal to the premiums paid by the named beneficiary after receipt of all incidents of ownership is exempt from the tax imposed by M.S. § 291.01, Subd. 5.

(d) The full or partial exemptions set forth in paragraphs (a) through (c) do not apply to cases where the decedent-insured owns incidents of ownership in the policy upon his death as set forth in Inh Tax 71 nor to cases where the insured at no time held an incident of ownership in the policy as set forth in Inh Tax 68.

EXAMPLE 1: C procured a $25,000 life insurance policy in 1947 on his own life. In 1959, C sold and irrevocably assigned the policy to the Acme Company for a price equal to the replacement cost. Acme paid all premiums thereafter until C's death in 1962. No part of the proceeds are taxable because Acme, the beneficiary, paid full and adequate consideration in money or money's worth to the decedent-insured.

EXAMPLE 2: D purchased a life insurance policy on his own life in 1956. In 1957, D irrevocably assigned the policy to E. In 1958, E assigned the policy to F for a price of $1,000. F continued to pay premiums after the assignment until the death of the insured in the amount of $500. It was determined that the replacement cost of the policy at the time it was assigned to F was $1,300. $1,500 of the proceeds are not subject to taxation under Subdivision 5.

Inh Tax 104 Effect of the Insured's Ownership of the Policy.

The proceeds of life insurance are taxable in full if the decedent-insured held one or more incidents of ownership in the policy at the time of his death.

EXAMPLE 1: H applied for a life insurance policy naming W the irrevocable beneficiary. H held the right to surrender the policy for one-half of its cash surrender value and W held the right to surrender the policy for the other one-half of its cash surrender value. W paid all of the premiums. Upon H's death, one-half of the proceeds are taxable. No part of the taxable one-half of the proceeds are exempt due to the fact that W paid the insurance premiums.

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EXAMPLE 2: Widget Inc. applied for and was issued an accident insurance contract providing for an accidental death benefit on employee P. Under the terms of the contract, the employee had the right to name and change the beneficiary of the accidental death benefit. Upon the accidental death of P, the proceeds are taxable in full to the beneficiary named by P.

Inh Tax 105 The taxation of life insurance proceeds payable upon death of decedents dying after April 5, 1963 is subject to the following regulations:

In general.

(a) M.S. § 291.01 (5) provides for the inclusion in a decedent's taxable estate of the proceeds of insurance on the decedent's life (aa) receivable by or for the benefit of the estate (see Inh Tax 73 of this chapter), and (bb) receivable by other beneficiaries (see Inh Tax 74) of this chapter). The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies operating under the lodge system.

(b) Proceeds of life insurance which are not includible in the taxable estate under M.S. § 291.01 (5) may, depending upon the facts of the particular case, be includible under some other section of chapter 291. For example, if the decedent possessed incidents of ownership in an insurance policy on his life but gratuitously transferred all rights in the policy in contemplation of death, the proceeds would be includible under M.S. § 291.01, Subd. 1. M.S. § 291.01 (5) has no application to the inclusion in the taxable estate of the value of rights in an insurance policy on the life of a person other than the decedent, or the value of rights in a combination annuity contract and life insurance policy on the decedent's life (i.e., a "retirement income" policy with death benefit or an "endowment" policy) under which there was no insurance element at the time of the decedent's death.

(c) The amount to be included in the taxable estate under M.S. § 291.01 (5) is the full amount receivable under the policy. If the proceeds of the policy are made payable to a beneficiary in the form of an annuity for life or for a term of years, the amount to be included in the taxable estate is the one sum payable at death under an option which could have been exercised either by the insured or by the beneficiary, or if no option was granted, the sum used by the insurance company in determining the amount of the annuity.

Inh Tax 106 Receivable by or for the benefit of the estate.

M.S. § 291.01 (5) requires the inclusion in the taxable estate of the proceeds of life insurance on the decedent's life receivable by the executor or administrator, or payable to the decedent's estate. It makes no difference whether or not the estate is specifically named as the beneficiary under the terms of the policy. Thus, if under the terms of an insurance policy the proceeds are receivable by another beneficiary but are subject to an obligation, legally binding upon the other beneficiary, to pay taxes, debts, or other charges enforceable against the estate, then the amount of such proceeds required for the payment in full (to the extent of the beneficiary's obligation) of such taxes, debts, or other charges is includible in the taxable estate. Similarly, if the decedent purchased an insurance policy in favor of another person or a corporation as collateral security for a loan or other accommodation, its proceeds are considered to be receivable for the benefit of the estate. The amount of the loan outstanding at the date of

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the decedent's death, with interest accrued to that date, will be deductible under M.S. § 291.07.

Inh Tax 107 Receivable by other beneficiaries.

(a) M.S. § 291.01 (5) requires the inclusion in the taxable estate of the proceeds of insurance on the decedent's life not receivable by or for the benefit of the estate if the decedent possessed at the date of his death any of the incidents of ownership in the policy, exercisable either alone or in conjunction with any other person. However, if the decedent did not possess any of such incidents of ownership at the time of his death nor transfer them in contemplation of death, no part of the proceeds would be includible in his taxable estate under M.S. § 291.01 (5). Thus, if the decedent owned a policy of insurance on his life and, 4 years before his death, irrevocably assigned his entire interest in the policy to his wife retaining no reversionary interest therein (see subparagraph (c) of this regulation), the proceeds of the policy would not be includible in his taxable estate under M.S. § 291.01 (5).

(b) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.

(c) The term "incidents of ownership" also includes a reversionary interest in the policy or its proceeds, whether arising by the express terms of the policy or other instrument or by operation of law, but only if the value of the reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the policy. As used in this subparagraph, the term "reversionary interest" includes a possibility that the policy or its proceeds may return to the decedent or his estate and a possibility that the policy or its proceeds may become subject to a power of disposition by him. In order to determine whether or not the value of a reversionary interest immediately before the death of the decedent exceeded 5 percent of the value of the policy, the principles contained in paragraph (c) (3) and (4) of federal regulation 20.2037-1 modified for the purposes of this regulation, insofar as applicable, shall be followed under this subparagraph. In that connection, there must be specifically taken into consideration any incidents of ownership held by others immediately before the decedent's death which would affect the value of the reversionary interest. For example, the decedent would not be considered to have a reversionary interest in the policy of a value in excess of 5 percent if the power to obtain the cash surrender value existed in some other person immediately before the decedent's death and was exercisable by such other person alone and in all events. The terms "reversionary interest" and "incidents of ownership" do not include the possibility that the decedent might receive a policy or its proceeds by inheritance through the estate of another person, or as a surviving spouse under a statutory right of election or a similar right.

(d) A decedent is considered to have an "incident of ownership" in an insurance policy on his life held in trust if, under the terms of the policy,

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the decedent (either alone or in conjunction with another person or persons) has the power (as trustee or otherwise) to change the beneficial ownership in the policy or its proceeds, or the time or manner of enjoyment thereof, even though the decedent has no beneficial interest in the trust. Moreover, assuming the decedent created the trust, such a power may result in the inclusion in the decedent's taxable estate under M.S. § 291.01 (1) and the regulations applicable thereto of other property transferred by the decedent to the trust if, for example, the decedent has the power to surrender the insurance policy and if the income otherwise used to pay premiums on the policy would become currently payable to a beneficiary of the trust in the event that the policy were surrendered.

(e) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy.

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CHAPTER ELEVEN: INH TAX 111-125

DISCLAIMER OF INTERESTS PASSING BY INHERITANCE OR SURVIVORSHIP

Inh Tax 111 Definitions.

(a) "Beneficiary" includes any person entitled to take an interest (unless he disclaims such interest or any part thereof) as a grantee; as a donee; under any assignment or other instrument of conveyance or transfer; by succession to a disclaimed interest; as beneficiary of an inter vivos trust or insurance contract; or pursuant to the exercise or non-exercise of a testamentary power of appointment; as a donee of a power of appointment created by a testamentary instrument; in any other way under a testamentary instrument; by intestate succession; by devise, legacy or bequest; by succession to a disclaimed interest by will, intestate succession, or through the exercise or non-exercise of a testamentary power of appointment; by reach of a renunciation or election to take against a will; as beneficiary of a testamentary trust by reason of the exercise or non-exercise of a testamentary power of appointment; as donee of a power of appointment created by a testamentary instrument; or in any other way under a testamentary instrument.

(b) "Interest" means and includes the whole of any property, real or personal, legal or equitable, or any fractional part, share, or particular portion or specific assets thereof, or any estate in any such property or power to appoint, consume, apply or expend property or any power or privilege of immunity relating thereto. "Interest", as herein defined, does not include legal title to property held in a fiduciary capacity, or in any other capacity where ownership, enjoyment or possession of the interest does not vest in the named holder.

(c) "Disclaimer" means a written instrument which declines, refuses, renounces or disclaims an interest which would otherwise be succeeded to by a beneficiary, where such instrument defines the nature and extent of the interest disclaimed, and which must be signed, witnessed and acknowledged by the disclaimant in the manner provided for deeds to real estate. For purposes of the tax imposed by M.S., Chapter 291, a renunciation or disclaimer of any interest or part thereof will not be given recognition by the Commissioner of Taxation unless such renunciation or disclaimer is made pursuant to the provisions of M.S. §§ 525.212, 501.211 or 525.532, or pursuant to a final judicial decree or court approved settlement. The following examples are illustrative:

EXAMPLE 1: Under the will of H, who died on January 1, 1969, W, his widow, received the entire estate. The certificate of probate was filed on July 15, 1969. On October 15, 1969, W renounced and elected to take her statutory share (see M.S. §§ 525.212 and 525.16). Under M.S. § 525.16, the balance of the estate passed to C, only child of H and W. On April 1, 1970, C, who has three children, disclaimed the interest passing to him from H's estate. The effect is as follows:

The one-half which C received when W disclaimed will be taxed in equal shares to each of C's three children as his interest became indefeasibly fixed both in quality and quantity when W renounced on October 15, 1969, and his disclaimer was within the six-month period which ended April 15, 1970.

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EXAMPLE 2: At her death on May 1, 1968, M, and her son, S, held various bank accounts and certificates of deposit totalling $100,000 in their joint names. D, daughter of M, brought an action claiming that the bank accounts and certificates of deposit had been held in the joint names of M and S for the convenience of M, and that consequently, she was entitled to one-half of the estate under the laws intestacy. On December 1, 1969, the Court decided in favor of D and ordered that the entire estate be submitted to the jurisdiction of the Probate Court. On March 15, 1970, D duly disclaimed her interest. The interest so disclaimed will be taxed to D's two children in equal shares as the interest disclaimed shall be distributed in the same manner as if D had died immediately before her mother. (See M.S. § 501.211, subd. 5; M.S. § 525.532, subd. 5, and M.S. § 525.16).

Inh Tax 112 Disclaimer Procedures.

(a) The procedure for disclaiming probate assets varies from that required for disclaiming non-probate assets. However, at times, it is difficult to tell whether an interest is represented by a probate or non-probate asset. A precise definition of these two terms is not available. M.S. § 291.005 defines "probate assets" as all the property of a decedent required by Chapter 525 to be listed on a representative's inventory, in cases where administration is had in a Minnesota Probate Court. M.S. § 525.13 states that, "As used in M.S. §§ 525.13 to 525.173, the word 'estate' includes every right and interest of a decedent in property, real or personal, except such as are terminated or otherwise extinguished by his death." Although M.S. §§ 525.13 to 525.173 relate to intestate succession, the definition set out in 525.13 appears to be appropriate for all probate assets whether the decedent died testate or intestate.

The following illustrations may be of assistance:

Description of Property	Probate	Non-Probate
Insurance proceeds paid to named beneficiaries	No	Yes
Insurance proceeds paid to the estate	Yes	No
Joint tenancy property	No	Yes
Joint bank account	No	Yes
U. S. "E" bonds payable to decedent	Yes	No
U. S. "E" bonds payable to decedent or other named person	No	Yes
U. S. "E" bonds payable on death to named person	No	Yes
Bank account established by decedent during life in trust for named beneficiary (Totten trust)	No	Yes
Revocable trust	No	Yes
Irrevocable trust (unless paid to estate)	No	Yes
Annuity payable to decedent where any refund is payable to his estate	Yes	No
Annuity payable to decedent, and upon his death to named beneficiary	No	Yes
Property owned by decedent	Yes	No

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Partnership interest owned by decedent	Yes	No
General power of appointment (as defined in M.S. § 291.01, subd. 3) if exercised by and in favor of decedent's estate or his creditors	Yes	No
General power of appointment if property passes to named individuals in default of exercise	No	Yes
General power of appointment if property passes to decedent's estate in default of exercise	Yes	No
Limited power of appointment (a power which is not a general power is usually described as a limited power) whether exercised or not	No	Yes
Employer's pension plan proceeds (if paid to estate)	Yes	No
Employer's pension plan proceeds (if paid to named beneficiary	No	Yes

(b) Under M.S. §§ 501.211 and 525.532, the interest must be disclaimed within six months after the death of the person from whom the interest was received (generally described as the decedent) or after the effective date of the non-testamentary instrument which created the interest. However, at the expiration of the six-month period, if the disclaimant has not been finally ascertained as a beneficiary or if his interest has not then become indefeasibly fixed, both in quality and quantity, (see following Example 2 for definitions of these terms), the disclaimer must be filed no later than six months after the person disclaiming has been ascertained as the beneficiary of the interest to be disclaimed, or the disclaimant's interest has become indefeasibly fixed both in quality and quantity. The six-month period shall be measured from the effective date until the date immediately preceding the same date six months hence. (For example, if the effective date is February 16, 1969, the disclaimer must be filed before August 16, 1969 in order to be within the six-month period.) The term "indefeasible" means that which cannot be defeated, revoked or made void. This term is generally applied to an estate or right which cannot be defeated.

EXAMPLE 1: F, a widower bequeathes the residue of his estate to S, his son, and D, his daughter. Among the assets were 1,000 shares of Wildcat Oil Corporation stock valued on March 1, 1969, the date of F's death, at $1.00 per share. On November 1, 1969, Wildcat Oil Corporation stock suddenly rose to $50.00 per share as a result of oil discoveries made on its land holdings. S then seeks to disclaim his share of Wildcat Oil Corporation stock on the basis that he was not aware of the value as of March 1, 1969. This disclaimer will not be given effect as S was ascertained as beneficiary at the date of F's death, and his interest in such stock is indefeasibly fixed. The sudden and unexpected rise in the stock value has no effect on the six-month limitation period.

EXAMPLE 2: Under the terms of a testamentory trust, B, brother of decedent D, received the income for life with the remainder to B's children. D died on May 1, 1969. B disclaims his right to receive the income on November 15, 1969. The disclaimer will not be given effect for inheritance tax purposes for the following reasons:

Quality with respect to an estate is described as the "character of an estate as determined by the manner in which it is to be held or enjoyed."

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Thus, the quality was fixed as the interest was an estate for life. Under the terms of the instrument, he was entitled to all the income that the property would earn during his lifetime. Although the total amount of income could not be ascertained, the quantity was fixed, namely, all of the income. (The same would be true if S received a specified portion of the income.)

EXAMPLE 3: H died in January, 1964. Under the terms of his will, W, wife, was given a general power of appointment over property valued at $250,000.00. The will also provided for a testamentary trust whereby T, trustee, is authorized to pay over to W from time to time, in his sole discretion, all or any portion of the income or principal that he deems necessary for her health, welfare, general well-being, or to maintain her in the style consistent with her position in the community. All the principal and undistributed income remaining at her death are to be paid over to S, son, and D, daughter of the decedent in equal shares free from trust. From 1964 through 1968, T paid over to W income from the residuary trust. Thereafter, no part of the income was paid to W. On September 1, 1969, W disclaims any interest in the principal or undistributed income of the residuary trust. Such a disclaimer will be given effect for inheritance tax purposes as her interest in the residuary trust had not been indefeasibly fixed at the date of H's death in 1964.

EXAMPLE 4: In the facts under Example 3, on January 15, 1970, four and one-half months after W disclaimed, S disclaims his share of the residuary trust. As S's interest was not indefeasibly fixed until September 1, 1969, the disclaimer will be given effect for inheritance tax purposes.

EXAMPLE 5: Decedent D left his entire estate to his two brothers B and C in equal shares after providing for payment of all expenses of administration, funeral expenses, expenses of last illness and all debts owed by D. D died on February 1, 1969. Probate proceedings were started on September 15, 1969. B filed a disclaimer on December 1, 1969. Such disclaimer will not be given effect for inheritance tax purposes as the interest of B and C was fixed in quality and fixed in quantity. B and C each were entitled absolutely to one-half the value of the residuary estate, although the precise value of their interests could not be known until distribution was effected.

EXAMPLE 6: D, by will, leaves $50,000 to his sister provided she is living at the time of final distribution of the probate estate. D dies on May 1, 1967. On March 15, 1969, prior to final distribution of the estate, S, his sister, disclaims. As her interest depended upon her surviving the date of distribution of the estate, the disclaimer by S will be given effect for inheritance tax purposes.

EXAMPLE 7: H devised property to W, his wife, with the provision that unless she survived him by five months, the property was to go to A. H died on July 1, 1968. W's interest then vested on December 1, 1968. On May 20, 1969, W disclaims. The disclaimer is effective for inheritance tax purposes as she disclaimed within six months of the date when her interest vested.

(c) Disclaiming Probate Assets. Where the interest sought to be disclaimed is represented by a probate asset, the disclaimer shall be filed in the Probate Court wherein the estate of the decedent, from whom such interest has been received or would have been received but for the disclaimer, is being administered. In the event that the estate has not been submitted to admini-

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stration prior to the filing of the disclaimer, the disclaimant should file the necessary documents with the appropriate Probate Court. See M.S. § 525.82 regarding venue. The disclaimant shall deliver copies of the disclaimer to the Commissioner of Taxation, to the representative, to the trustee (if one has been appointed), or to any other person having legal title to or possession of the property disclaimed.

(d) Disclaiming Non-Probate Assets. Where the interest sought to be disclaimed is represented by a non-probate asset, the disclaimer shall be filed in any District Court of the state of Minnesota. The disclaimant shall deliver or mail a copy of the legal disclaimer to the Commissioner of Taxation, to the trustee of any trust in which the interest disclaimed exists, and to any other person who has legal title or possession of the property sought to be disclaimed. In the event that the interest disclaimed reverts to the estate of the decedent, the representative of the estate and the Probate Court each shall be furnished with a copy of the disclaimer.

EXAMPLE 1: F had previously established a revocable trust retaining for himself the income for life with principal payable to his son S. The trust instrument also provided that in the event that S failed to survive F, the principal was to be distributed to S's children. S, who has three children, files a disclaimer in the District Court two months after F dies. S must submit copies of the disclaimer certified by the Clerk of Court to the trustee and to the Commissioner of Taxation.

EXAMPLE 2: Bank deposits are registered in the names of F, S, and D, father, son and daughter, respectively. F died on March 1, 1969. On May 1, 1969, S files a disclaimer in the District Court. S is required to file a certified copy of the disclaimer with the Commissioner of Taxation and with the depository.

(e) As the effect of the "Disclaimer Law" is to create a possibility whereby the beneficiary may divest himself of his interest, the provisions of M.S. § 291.11, subd. 5, are applicable. Thus, a claim for refund based upon a disclaimer shall be made pursuant to the provisions of M.S. § 291.11, subd. 5.

Inh Tax 113 Effect of Disclaimer on Non-Probate Assets. The general rule provided in M.S. § 501.211, subd. 5, requires distribution of the disclaimed interest in the same manner as would be the case had the disclaimant died just prior to the decedent's death, or had the disclaimant died just prior to the event that caused his interest to become indefeasibly fixed. This rule may be abrogated where the decedent provided in the nontestamentary instrument which created the interest, for distribution of the interest in the event of a disclaimer. The statute specifically provides that the disclaimant shall not be excluded from sharing in a gift of the decedent where such residue includes the interest disclaimed, unless the disclaimer so provides. The Commissioner will follow this provision with respect to inheritance taxes.

EXAMPLE 1: F established a revocable trust retaining for himself the income for life with the principal to be paid over to S upon F's death. The trust instrument provided that if S failed to survive F, the principal was to be paid over to his issue in equal shares. F died on May 1, 1969. S duly disclaims on October 16, 1969. The Commissioner will assess a tax with respect to one-third of the principal of the trust passing to each of S's three children.

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EXAMPLE 2: S was beneficiary of an insurance policy on the life of F, father. In the event that S did not survive F, the proceeds were to be paid over to F's estate. F died testate on June 1, 1969, leaving his entire probate estate to W, wife. S duly disclaims his interest on September 1, 1969, and surrenders the proceeds to the representative of F's estate. W will be taxed on the insurance proceeds as the effect of S's disclaimer with respect to the insurance proceeds is as though he had died just prior to F. Consequently, such insurance proceeds will be taxed in accordance with F's will.

EXAMPLE 3: M created a revocable trust providing for income to D, daughter, for life with the remainder as D shall appoint by deed or will. M died on April 15, 1969, and was survived by D and S, her two children. D files a disclaimer and requests that the trust principal be assigned to her five minor children pursuant to the general power of appointment granted to her under the trust instrument. The Commissioner will assess the tax on the basis that D and S, as intestate heirs of M share equally in the principal of the disclaimed trust. As D is treated as though she died immediately preceding M, she could not dispose of the trust principal under the general power of appointment and at the same time disclaim her interest.

Inh Tax 114 Disclaimer of Joint Ownership and Joint Tenancy Interest.

(a) Joint Bank Accounts, Certificates of Deposit and Certain United States Government Bonds. Under both Federal and Minnesota gift tax regulations, where a person creates a joint bank account (or a similar type of ownership by which he can regain the entire fund without the other joint owner's consent), no gift results until and unless the joint owner who furnished no part of the funds draws upon the account for his own benefit. At that time, a gift to the extent of the amount withdrawn by such joint owner is a gift. Similarly, where a person purchases United States bonds, registered in his name and/or the name of another, there is a gift to the named holder who did not furnish the funds for the purchase at the time such person surrenders the bond for cash without being required to account for any part of the proceeds to the original purchaser. Thus, if the person who furnished the original consideration dies, the surviving joint owner may disclaim his interest in such joint ownership property in accordance with the provisions of the regulations relating to the disclaimer of non-probate assets.

(b) Joint Tenancy Property. A joint tenancy is characterized by the four unities of time, title, interest and possession, and if any one of these elements is lacking, the estate is not one in joint tenancy. In effect, each of the tenants has a fixed interest in the entire property subject to the following conditions:

(1) Divestment of the entire property if he predeceases his other joint tenants.

(2) By some act of his joint tenants, or by operation of law which divests him of all but his proportionate share of the joint tenancy property.

Where a joint tenant dies and there has been no divestment prior to death, the surviving joint tenant is not a beneficiary entitled to disclaim in accordance with M.S. § 501.211, subd. 1 (a).

In order to distinguish a joint tenancy from a tenancy in common, the deed, stock certificates, notes or other evidence of ownership must ex-

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pressly declare that the property is being held in joint tenancy. The usual recital is as follows:

"A and B, as joint tenants, but not as tenants in common, with the right of survivorship."

A surviving joint tenant who has not disclaimed a gift represented by an interest in joint tenancy will not be permitted to disclaim as a beneficiary by reason of the death of the other joint owner of the property.

EXAMPLE 1: Prior to his death, F had purchased 1,000 shares of Modern Electronics, Inc., which he had registered in the names of himself, S and D, his son and daughter, respectively. F then put the stock certificates in his desk without notifying S or D, nor did he file a gift tax return. No dividends were declared on the stock during F's lifetime. F died on March 1, 1969. On September 15, 1969, F's executor discovered the stock certificates valued at $10 per share at F's death, by September 15, 1969, it had increased in value to $25 per share. On September 17, 1969, S disclaims the gift of the joint tenancy property made to him at the time the stock was registered in the joint names of F, S and D. His timely disclaimer of the gift which was made within six months of the time he had knowledge of the gift, will result in the value of the stock being taxable to D as the surviving joint tenant.

EXAMPLE 2: F, a widower, conveys Blackacre to himself and S, his son, as joint tenants on May 1, 1969. On March 1, 1970, F files a gift tax return reporting the gift. As Blackacre was income-producing property, S received one-half the income subsequent to the gift and reported the same on his tax return. On July 1, 1970, F dies, and S immediately disclaims his interest in Blackacre. Such disclaimer will not be given effect for inheritance tax purposes.

EXAMPLE 3: H purchases Whiteacre, an apartment house, and causes the property to be registered in the names of H and W, his wife, as joint tenants but not as tenants in common with the right of survivorship. The date of the purchase was December 1, 1969. Under the provisions of M.S. § 292.02, subd. 7, H is not required to file a gift tax return unless he elects to treat the creation of the joint tenancy in Whiteacre as a gift. H does not file a return. Thereafter, W receives one-half the income from Whiteacre and reports such income on her Minnesota income tax return. H dies on July 1, 1970. W then disclaims her interest in Whiteacre on the grounds that the creation of the joint tenancy was not treated as a gift by H, her deceased joint tenant. Such disclaimer will not be given effect for inheritance tax purposes as W, who was aware of her interest as a joint tenant, was not a survivor in accordance with M.S. § 501.211, subd. 1(a).

Inh Tax 115 Effect of Disclaimer on Distribution of Probate Assets.

M.S. § 525.532, subd. 5, requires distribution of the disclaimed interest in the same manner as would be the case had the disclaimant died immediately before the death of the decedent, or immediately preceding the event which caused the disclaimant's interest to become indefeasibly fixed. The beneficiary of an interest may disclaim such interest, in whole or in part, without being barred from sharing in the distribution of the residue, were he entitled by devise or bequest to a share thereof, unless his interest in such residue is also included in the disclaimer.

Under M.S. § 525.532, subd. 5, an interest in the estate of an intestate may be declined, refused, or disclaimed in accordance with the provisions

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applicable thereto. **Black's Law Dictionary, Revised Fourth Edition,** defines "disclaimer" as "the disavowal, denial or renunciation of an interest, right, or property imputed to a person, or alleged to be his." As the terms "declined", "refused", and "disclaimed" are synonymous, the provisions governing disclaimers are applicable to a beneficiary declining or refusing an interest in an intestate's estate.

As the effect of a disclaimer of an interest or any part thereof requires the distribution of such interest in the same manner as though the disclaimant had died immediately prior to the death of the decedent, such disclaimed interest is subject to M.S. § 525.203, commonly referred to as the "Anti-lapse Statute." Thus, a disclaimed interest will be distributed to the issue of the disclaimant (assuming that the disclaimant is a child or other blood relative of the decedent), unless the will or other controlling testamentory instrument requires otherwise.

EXAMPLE 1: "D"s will bequeathed $30,000 to "B", his brother, with the residue passing to D's three children in equal shares. B, who had no issue, duly disclaims. The disclaimed interest of $30,000 is includible in the residue taxable to D's three children.

EXAMPLE 2: D's will bequeathed $30,000 to B, his brother, and the residue was bequeathed to D's three children. B, who has two children, duly disclaims. The disclaimed interest will be taxed to the two children of B, in equal shares pursuant to the provisions of M.S. § 525.203.

EXAMPLE 3: H died intestate survived by W, widow, D, daughter, and S, who is a son by a former marriage. He had no other heirs at law. W and D, who had funds of their own far in excess of the value of H's estate, each duly disclaims her share of H's estate. As D was childless, and W had no other children other than D, the entire intestate estate will be taxed to S.

EXAMPLE 4: H died intestate survived by W, widow, D, daughter, and S, who is a son by a former marriage. D had two children of her own. W and D duly disclaim. As the effect of the disclaimer is as though W and D had died just prior to the time of H's death, D's two children are entitled to D's one-half share in the residue. Accordingly, one-half of the residue will be taxed to S and one-fourth to each of D's two children.

EXAMPLE 5: Same facts as Example 4. Subsequent to D's disclaimer, the guardian of her minor issue disclaims their interest in the residue pursuant to M.S. § 525.532, Subd. 2. Under such circumstances, the value of the entire residue will be taxed to S.

EXAMPLE 6: H dies leaving $50,000 to W, his wife with the residue to his sister, S. W had two children by a prior marriage. W, who is wealthy in her own right duly disclaims. The $50,000 bequest, as well as the residue, will be taxed to S, as the Anti-lapse Statute is not applicable to W. She is not a blood relative of H.

EXAMPLE 7: D bequeathed $50,000 to S, his sister, with the residue to S and his two brothers. In addiiton, D provided that if S fails to survive him, the bequest to her shall be distributed as part of the residue. S, who has two children, duly disclaims the $50,000 bequest, but does not disclaim her share of the residue. Consequently, S and her two brothers will be taxed on the value of one-third of the residue which includes the $50,000 bequest.

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EXAMPLE 8: Same facts as in Example 7 except that S disclaims, in addition to the $50,000 specific legacy, her share of the residue. Consequently, the Anti-lapse Statute is applicable, and the tax will be imposed on the following distribution: One-third to each of D's two brothers, and one-sixth to each of S's two children.

Inh Tax 116 Disclaimer of Interest Existing Prior to May 22, 1965. The provisions of M.S. §§ 291.111, 501.211 and 525.532 were enacted into law as part of Chapter 525, Laws of 1965, effective May 22, 1965. However, in M.S. § 501.211, subd. 9, and M.S. § 525.532, subd. 9, the Legislature provided that where an interest has not become indefeasibly fixed both in quality and quantity or where the person entitled to an interest had not become finally ascertained on May 22, 1965, such interest could be disclaimed in accordance with M.S. § 501.211 or 525.532, whichever is appropriate. Consequently, such a disclaimer will be given effect of inheritance tax purposes in accordance with M.S. § 291.111.

EXAMPLE 1: D, who died September 15, 1963, created a testamentary trust which gave the trustee discretion to pay over income to S, D's son, or to add such income to the principal. The trust instrument also provided that the principal, plus any undistributed income should be paid over to S at the time he attains the age of 45. In the event that S were to die prior to his 45th birthday, the trust instrument provided that the principal plus undistributed income, should be paid over to S's issue or held in trust for them until the youngest reached his majority. In the event that S were to die without issue, the principal and undistributed income should be paid to N, daughter of D's deceased brother. On May 15, 1969, S, whose 45th birthday is May 29, 1969, and who has two children duly disclaims his interest in the trust. As his interest is still contingent on this date, his disclaimer will be given effect for inheritance tax purposes. Consequently, the value of the trust principal will be taxed to his two children. See Inh Tax 128 for refunds due if the high tax had been previously paid.

EXAMPLE 2: Same facts as above except that S is childless. On May 17, 1969, two days after S has disclaimed, N, who has four children of her own, disclaims. As she was not ascertained as a beneficiary until May 15, 1969, her disclaimer will be given effect for inheritance tax purposes. Consequently, the tax will be imposed on N's four children to the extent of the value of the principal.

In both Examples 1 and 2 immediately above, the value of the principal will be based upon the values assigned on the applicable valuation date with respect to the inheritance tax return filed for D's estate. See Inh Tax 128 for refunds due if the high tax has previously been paid.

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CHAPTER TWELVE: INH TAX 126-135

LIFE ESTATES: REMAINDERS — CONTINGENT INTERESTS — COMPOSITION AGREEMENTS

Inh Tax 126 Taxation of Life Estates and Remainder Interests.

(a) In general. Under M.S. § 291.01 Subd. 2, transfers that are subject to inheritance tax under M.S. Chapter 291 "shall be imposed when any — person becomes a beneficiary entitled in possession or expectancy to any property or the income thereof by any — transfer."

M.S. § 291.11, Subd. 3, provides that where a transfer subject to tax under M.S. Chapter 291 is made in trust, "and the right of the beneficiaries of the trust to receive the property embraced in the trust is susceptible of present valuation — the tax thereon shall be paid at the same time, and in the same manner, and in like amount, that would be the case if the beneficiary of such trust received the same directly from the decedent or the person from whom the property is transferred."

An estate in possession is defined as one whereby the owner has an immediate right to possession. An estate in expectancy is defined as one where the right to possession thereof is postponed until some future time. In Minnesota, expectant estates or interests in personalty are recognized and are descendable, devisable and alienable in the same manner as are estates in possession. Life estates may be created either in personalty or in real estate. A life tenant or a tenant for years may convey out or transfer his estate.

Thus, the inheritance tax is applicable to any beneficial interest passing as the result of decedent's death, irrespective of whether such interest is represented by an estate for life, an estate for years, income for life, income for a term certain, an annuity for life, an annuity for a term certain, a remainder interest after other interests have terminated. The tax is applicable whether such beneficial interests are vested or contingent, or whether the property is real or personal.

Each beneficiary is assessed an inheritance tax based upon the money value of the property to which he is entitled; his relationship to the decedent determines the rates and exemptions applicable to this money value.

Where the beneficial rights require the valuation of both present and future interests, M.S. § 291.11, Subd. 2, provides that the value of such interests shall be "determined by the rule, method and standard of mortality and values employed by the Commissioner of Internal Revenue in determining the valuation for federal estate tax purposes under the Internal Revenue Code of 1954 as amended." These values are contained in the **Actuarial Values for Estate and Gift Tax** issued and sold by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. Reproductions of Tables 1 and 2 are attached herewith.

EXAMPLE 1: D, decedent, by will bequeaths property to T in trust to pay the income to S, D's sister, for life. Upon S's death, the corpus shall be surrendered to C, D's son, free of trust. At D's death, S was 50 years of age. At the applicable valuation date the trust property was appraised at $200,000. Table 1 lists as the present worth of the life estate for a person aged 50 the factor of .51970. (Column 3). The remainder interest has a present worth of .48030. (Column 4). Thus, the value for

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inheritance tax purposes of S's life estate is .51970 x $200,000, or $103,940. C's remainder interest is valued at .48030 x $200,000, or $96,060.

EXAMPLE 2: Same facts as Example 1. However, S dies eight months after D. As S was "beneficially entitled" to receive the income for life, and her interest was susceptible of valuation at date of D's death, the factor of .51970 employed in Example 1 is used in this case. Thus, a value of $103,940 will be the basis of taxing S, and as a corollary, a value of $96,060 will be assigned to C, despite the fact that the latter will come into enjoyment and possession of the entire corpus within a relatively brief period of time after D's death.

EXAMPLE 3: D, decedent, by will bequeaths property to T in trust, to pay the income for life to B, his brother, aged 70, and then to pay the income for life to S, his sister, aged 60. When both named life tenants have deceased, the principal shall be surrendered free of trust to C, D's son. The value of the principal is $200,000. The life estate factor for a person aged 60 is .39679. Therefore, the present worth of S's life estate if she were immediately entitled to receive the benefits would be $79,358. However, as she is not entitled to any portion of the income until B's death, the present worth of B's life estate must be subtracted from the present worth of her life estate. The life estate factor for a person aged 70 is .27370. Consequently, B is taxed on $54,740 (.27370 x $200,000), and S is taxed on $79,358 minus $54,740, or $24,618, and C, the remainderman is taxed on $200,000 minus $54,740 minus $24,618 (the life estate value of S, the younger beneficiary,) or $120,642. The same result is achieved by subtracting the value of S's life estate ($79,358) from $200,000. However, for an alternative method, see **Actuarial Values for Estate and Gift Tax,** U. S. Treasury Department, I.R.S. Publication #11.

EXAMPLE 4: D, decedent, by will bequeaths property to T in trust. T is required to pay $6,000 per year to S, D's sister, at the rate of $500.00 per month beginning on the date of her 60th birthday. At her death, the balance will be paid to the First Church, an exempt religious institution. The will provides that S's taxes shall be paid from the principal of the trust. The appraised value of the trust property is $100,000.

The annuity factor for a person aged 60, as listed in Table 1, is 11.3369. Multiplying this factor, 11.3369 by $6,000 (amount to be paid yearly), yields $68,021.40. However, Table 2 requires that where an annuity is due at the beginning of the month, the value of the annuity must be increased by multiplying the product as derived in the preceding sentence of the example by the factor applicable. The applicable factor, according to the table, is 1.0189. Thus, the valuation taxable to "S" is $69,307, that is, $68,021.40 multiplied by the factor 1.0189. However, according to Inh Tax 56, "A death tax imposed on legatee A, which is required to be borne by some other legatee, shall constitute a taxable legacy to A and a diminution of the legacy taxable to such other legatee." Consequently, S's legacy of $69,307 must be increased by the tax and tax on tax due with respect to S. The tax and tax on tax to S is $5,934.11. (See Inh Tax 56 for method of computing tax and tax on tax.) Thus, the total value of the corpus taxable to S, is $69,307, plus $5,934.11, or $75,241.11. The balance of $24,758.89 is the present value of the property passing to the First Church, and, pursuant to M.S. § 291.05, clause (1), is exempt from tax.

EXAMPLE 5: Same facts as above in Example 4 except that, under the terms of the trust, the first payment to S shall be made one month after she reaches the age of 60. Therefore, $68,021.40, (see calculation in Example

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4 above), is multiplied by the factor 1.0159, thus yielding an amount taxable to S of $69,102.94. The tax and tax on tax on this amount is $5,911.44. Thus, the total taxable to S is $69,307, plus $5,911.44, or $75,218.44. The balance of $24,781.56 is attributable to the First Church and is non-taxable.

EXAMPLE 6: D, decedent, by will, bequeaths property worth $200,000 to T, in trust, to pay an annuity of $10,000 yearly to the University of Minnesota for ten years. At the expiration of this period, the principal is to be surrendered to C, D's son, free from trust. Under the terms of T's will, payments are to be made to the University four times yearly at the beginning of each quarter. Table 2 of the Regulation lists the factor for an annuity for a ten-year term certain as 8.3166. This factor, multiplied by $10,000, (the amount to be paid yearly), equals $83,166. As the payments are to be made at the beginning of each quarterly period, the adjustment factor of 1.0218, (see Table 2), must be multipled by the amount of $83,166. The total amount thus attributable to the University of Minnesota is $84,979.02. As the University of Minnesota is an exempt institution, no tax is assessed with respect to this amount. However, the difference between the principal of $200,000.00, and the $84,979.02 attributable to the University of Minnesota, or $115,020.98, is taxable to C.

(b) Tax on tax under income bequest from residue. Where a beneficiary is entitled to income for life or for a term certain from the residue of an estate, a provision requiring that the taxes due on such bequest be paid from the residue will not increase the value of the bequest by the amount of tax and tax on tax. Where a beneficiary is entitled to income from a specific fund and such bequest is to be paid to him free from tax, tax on tax is to be computed as an additional legacy, even though such income beneficiary, by reason of other provisions of the will is entitled to a share of the residue. Example 1 below illustrates the rule where the income is to be paid from the residue. Example 2 illustrates the rule where the income is to be paid out of a specific fund.

EXAMPLE 1: D's estate is appraised at $450,000. Pursuant to a marital deduction clause, the widow receives one-half of the adjusted gross estate (which is $400,000). No part of the estate is represented by a homestead. The residue of the estate is bequeathed in trust to T under a provision whereby T shall pay the income for life to W, aged 60, and upon her death shall surrender the principal of the trust free from trust to S, his son. The will provides that any death taxes (Minnesota inheritance tax) attributable to the marital deduction share of the estate passing to the widow shall be paid from the residue.

In order to ascertain the value of the residue, it is necessary to deduct from the gross estate all of the deductions allowable in the Probate Court, the share of the probate assets passing under the marital deduction clause, and the deduction for federal estate taxes. This computation is as follows:

Total gross estate	$450,000.00
Less deductions allowable in probate other than federal estate tax	50,000.00
	$400,000.00
Less federal estate tax	31,500.00
	$368,500.00
Less the amount attributable to the marital deduction	200,000.00
Value of remainder subject to residuary trust	$168,500.00

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Inasmuch as inheritance taxes attributable to that portion of the estate passing to W under the marital deduction clause must be paid by the representative from the residue, a tax and tax on tax computation must be made. Accordingly, the residue must be reduced by the following calculation: Tax on $200,000 (marital deduction) to a widow equals $6,400.00. The tax and tax on tax on this amount equals $6,808.51. (See Inh Tax 56 for the method of calculating tax and tax on tax.) Consequently, this reduces the residue from $168,500 to $161,691.49.

Life estate in residuary trust $161,691.49 x .39679 (life estate factor for a person aged 60), yields a taxable value of $64,157.57. Thus, the total amount taxable to W is:

Marital share	$200,000.00
Tax and tax on tax	6,808.51
Life estate in residue	64,157.57
	$270,966.08

The residue taxable to S is $97,533.92 ($368,500 less $270,966.08). Consequently, the inheritance tax assessed against W is $10,657.96. The tax assessed against S is $4,232.04. One point in the above example is worthy of note. No tax on tax is charged against the value of the life estate attributable to W, as a tax on tax would reduce the residue and consequently reduce the amount attributable to her life estate. Accordingly, as part of the burden of the tax on tax is borne by W, it is not taken into account in computing the value of her life estate.

EXAMPLE 2: D's will provides that S, his sister, is to receive the income from a $100,000 trust for life with the tax thereon to be paid from residue of estate. The remainder is to be paid to the First Church at her death. S is age 50 at date of D's death. S's life estate is valued at $51,970 (See Table 1). In addition, S receives 20% of the residue with the remaining 80% going to N, son of decedent's brother. The computation of the tax due is as follows:

Gross subject to distribution after payment of expenses of administration, federal estate taxes, etc.		$300,000.00
Deduction for trust	100,000.00	100,000.00
Residue		$200,000.00
Tax on tax less tax on tax for "S" 's life estate		4,007.77
Balance subject to distribution between S and N (Net Residue)		195,992.23
S's life estate from trust (including tax on tax)		55,977.77
20% of net residue ($195,992.23) =		39,198.45
Total taxable to S		95,176.22
Tax to Sister		7,927.62
80% of net residue to N ($195,992.23) =		156,793.78
Tax thereon to N		15,361.13

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TABLE I—SINGLE LIFE FACTORS FOR PRESENT WORTH OF ANNUITY, ETC.

TABLE I

Table, single Life, 3½ percent, showing the present worth of an annuity, or a life interest, and of a remainder interest

age x	Annuity a	Life estate I	Remainder A	Age x	Annuity a	Life estate I	Remainder A
0	23.9686	.83890	.16110	55	13.1218	.45926	.54074
1	24.9035	.87162	.12838	56	12.7679	.44688	.55312
2	24.8920	.87122	.12878	57	12.4120	.43442	.56558
3	24.8246	.86886	.13114	58	12.0546	.42191	.57809
4	24.7378	.86582	.13418	59	11.6960	.40936	.59064
5	24.6392	.86237	.13763	60	11.3369	.39679	.60321
6	24.5326	.85864	.14136	61	10.9776	.38422	.61578
7	24.4188	.85466	.14534	62	10.6186	.37165	.62835
8	24.2982	.85044	.14956	63	10.2604	.35911	.64089
9	24.1713	.84600	.15400	64	9.9036	.34663	.65337
10	24.0387	.84135	.15865	65	9.5486	.33420	.66580
11	23.9008	.83653	.16347	66	9.1960	.32186	.67814
12	23.7600	.83160	.16840	67	8.8464	.30962	.69038
13	23.6161	.82656	.17344	68	8.5001	.29750	.70250
14	23.4693	.82143	.17857	69	8.1578	.28552	.71448
15	23.3194	.81618	.18382	70	7.8200	.27370	.72630
16	23.1665	.81083	.18917	71	7.4871	.26205	.73795
17	23.0103	.80536	.19464	72	7.1597	.25059	.74941
18	22.8511	.79979	.20021	73	6.8382	.23934	.76066
19	22.6870	.79404	.20596	74	6.5231	.22831	.77169
20	22.5179	.78813	.21187	75	6.2148	.21752	.78248
21	22.3438	.78203	.21797	76	5.9137	.20698	.79302
22	22.1646	.77576	.22424	77	5.6201	.19670	.80330
23	21.9801	.76930	.23070	78	5.3345	.18671	.81329
24	21.7902	.76266	.23734	79	5.0572	.17700	.82300
25	21.5950	.75582	.24418	80	4.7884	.16759	.83241
26	21.3942	.74880	.25120	81	4.5283	.15849	.84151
27	21.1878	.74157	.25843	82	4.2771	.14970	.85030
28	20.9759	.73416	.26584	83	4.0351	.14123	.85877
29	20.7581	.72653	.27347	84	3.8023	.13308	.86692
30	20.5345	.71871	.28129	85	3.5789	.12526	.87474
31	20.3052	.71068	.28932	86	3.3648	.11777	.88223
32	20.0699	.70245	.29755	87	3.1601	.11060	.88940
33	19.8288	.69401	.30599	88	2.9648	.10377	.89623
34	19.5816	.68536	.31464	89	2.7788	.09726	.90274
35	19.3285	.67650	.32350	90	2.6019	.09107	.90893
36	19.0695	.66743	.33257	91	2.4342	.08520	.91480
37	18.8044	.65815	.34185	92	2.2754	.07964	.92036
38	18.5334	.64867	.35133	93	2.1251	.07439	.92561
39	18.2566	.63898	.36102	94	1.9839	.06944	.93056
40	17.9738	.62908	.37092	95	1.8507	.06477	.93523
41	17.6853	.61899	.38101	96	1.7256	.06040	.93960
42	17.3911	.60869	.39131	97	1.6082	.05629	.94371
43	17.0913	.59820	.40180	98	1.4982	.05244	.94756
44	16.7860	.58751	.41249	99	1.3949	.04882	.95118
45	16.4754	.57664	.42336	100	1.2973	.04541	.95459
46	16.1596	.56559	.43441	101	1.2033	.04212	.95788
47	15.8388	.55436	.44564	102	1.1078	.03877	.96123
48	15.5133	.54297	.45703	103	.9973	.03491	.96509
49	15.1831	.53141	.46859	104	.8318	.02911	.97089
50	14.8486	.51970	.48030	105	.4831	.01691	.98309
51	14.5101	.50785	.49215				
52	14.1678	.49587	.50413				
53	13.8221	.48377	.51623				
54	13.4734	.47157	.52843				

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FACTORS FOR MONTHLY PAYMENTS, ETC.

3½ Percent

If a life annuity or an annuity certain is payable at the end of semiannual, quarterly, monthly, or weekly periods, the following adjustment factors should be used:

Semiannual	1.0087
Quarterly	1.0130
Monthly	1.0159
Weekly	1.0171

However, a provision that the *income* from property is to be paid in semi-annual, quarterly, monthly, or weekly installments does not affect the value to be assigned to the life interest.

If an *annuity certain* is payable at the *beginning* of annual, semiannual, quarterly, monthly, or weekly periods, the following adjustment factors should be used:

Annual	1.0350
Semiannual	1.0262
Quarterly	1.0218
Monthly	1.0189
Weekly	1.0177

For the method of applying these factors, see the examples illustrating the use of Tables I and II in the estate and gift tax regulations.

TABLE II

Table showing the present worth at 3½ percent of an annuity for a term certain, and a remainder interest postponed for a term certain

Number of years	Annuity for a term certain	Income for a term certain	Remainder postponed for a term certain	Number of years	Annuity for a term certain	Income for a term certain	Remainder postponed for a term certain
1	0.9662	.033816	.966184	31	18.7363	.655770	.344230
2	1.8997	.066489	.933511	32	19.0689	.667410	.332590
3	2.8016	.098057	.901943	33	19.3902	.678657	.321343
4	3.6731	.128558	.871442	34	19.7007	.689524	.310476
5	4.5151	.158027	.841973	35	20.0007	.700023	.299977
6	5.3286	.186499	.813501	36	20.2905	.710167	.289833
7	6.1145	.214009	.785991	37	20.5705	.719968	.280032
8	6.8740	.240588	.759412	38	20.8411	.729438	.270562
9	7.6077	.266269	.733731	39	21.1025	.738587	.261413
10	8.3166	.291081	.708919	40	21.3551	.747428	.252572
11	9.0016	.315054	.684946	41	21.5991	.755969	.244031
12	9.6633	.338217	.661783	42	21.8349	.764221	.235779
13	10.3027	.360596	.639404	43	22.0627	.772194	.227806
14	10.9205	.382218	.617782	44	22.2828	.779898	.220102
15	11.5174	.403109	.596891	45	22.4955	.787341	.212659
16	12.0941	.423294	.576706	46	22.7009	.794532	.205468
17	12.6513	.442796	.557204	47	22.8994	.801480	.198520
18	13.1897	.461639	.538361	48	23.0912	.808194	.191806
19	13.7098	.479844	.520156	49	23.2766	.814680	.185320
20	14.2124	.497434	.502566	50	23.4556	.820947	.179053
21	14.6980	.514429	.485571	51	23.6286	.827002	.172998
22	15.1671	.530849	.469151	52	23.7958	.832852	.167148
23	15.6204	.546714	.453286	53	23.9573	.838504	.161496
24	16.0584	.562043	.437957	54	24.1133	.843965	.156035
25	16.4815	.576853	.423147	55	24.2641	.849242	.150758
26	16.8904	.591162	.408838	56	24.4097	.854340	.145660
27	17.2850	.604988	.395012	57	24.5504	.859266	.140734
28	17.6670	.618346	.381654	58	24.6864	.864025	.135975
29	18.0368	.631252	.368748	59	24.8178	.868623	.131377
30	18.3920	.643722	.356278	60	24.9447	.873066	.126934

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First Church received ($100,000 — 51,970) =..... 48,030.00
Tax thereon (exempt entity) ..... —0—

Inh Tax 127 Limited Estates; Divestment by Beneficiaries. M.S. § 291.11, Subd. 4, provides that where an estate for life or for years can be divested by an act or omission of the beneficiary, the inheritance shall be taxed as if no such possibility existed. An income beneficiary who can only be divested of his estate for life or estate for years by his own actions must disclaim within the statutory six-month period. Such an income beneficiary can only be divested of his estate by some act or omission on his part; in short, if he so chooses, he may continue to enjoy the use, possession and income of the property for the entire term of the designated income period, whether it be for years or for his life. By contrast, the person entitled to disclaim an interest under M.S. §§ 501.211 and 525.532 is one whose rights may be defeated either by events beyond his control or by actions of other persons.

Subject to the rights to disclaim any interest within six months of its creation (See M.S. §§ 501.211, 525.532, 291.111 and Inh Tax 112(b)), any act or omission by the income beneficiary which terminates his vested limited estate will not prevent such interest from being taxed to him.

EXAMPLE: D devises Blackacre to S, son, for life provided S makes his home there. The value of the life estate will be taxed to S (unless he disclaims within six months of D's death) notwithstanding the possibility that his life estate would be terminated prior to his death were he to make his home elsewhere.

Inh Tax 128 Payment of High Tax. Minnesota Statutes, M.S. § 291.11, subd. 5, provides that where the rights, interests, or estate of a beneficiary "are dependent upon contingencies or conditions whereby they may be wholly or in part created, defeated, extended or abridged", the Commissioner may impose an inheritance tax at the highest rate possible under the terms of the will or other instruments creating these interests. Consequently, where, under the controlling instrument, a trustee possesses the right to allocate income among a designated group of beneficiaries, or to pay part or all of the corpus to a designated beneficiary or group of beneficiaries, the Commissioner, pursuant to M.S. § 291.11, subd. 5, may, in his discretion, assess the entire tax against one beneficiary entitled to such distribution, so as to yield the highest possible tax that could be assessed. As a corollary, the trustee or other person possessing this power may elect to pay the highest possible tax consisent with the controlling instrument. In either case, when all of the interests have vested, and the amounts taxable to the ultimate beneficiaries have been finally ascertained, and the amount of tax as thus assessed is less than the amount paid under the election to pay the highest tax, a refund of the difference will be made upon proper petition. The two-year limitation imposed by M.S. § 291.18 with respect to refunds is not applicable in those cases where the refund is made pursuant to M.S. § 291.11, subd. 5. However, application for refund must be made within two years following the vesting of the several interests. Where a composition agreement is entered into under the provisions of M.S. § 291.30, the provisions of M.S. § 291.11, subd. 5, and the regulations pertinent thereto are not applicable.

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The following examples are illustrative:

EXAMPLE 1: D's will bequeathed $100,000 to T in trust to distribute periodically the income for life to X, aged 60, and Y, aged 62, his sisters. The will further provided that T, in his sole discretion, shall determine the allocation between the two sisters upon the basis of their needs. Upon the deaths of X and Y, the corpus is to be surrendered free from trust to C, D's son. C does not receive any other benefit from D's estate. X also received taxable proceeds of $50,000 from an insurance policy on the life of D. The trustee elects to pay the highest tax instead of entering into a composition agreement with the Commissioner. The following computation is made:

X — Sister	$50,000	
Life estate in $100,000 trust (factor for person aged 60 — .39679)	39,679	
Taxable	$89,679	
Tax		$7,377.90
Taxable to C (C is an adult) $100,000 corpus less $39,679 = $60,321		
Tax		$1,999.26
Total high tax		$9,377.16

Two years later, X died. No distribution of income had been made to her. Three years after death of X, Y died. There had been distributed to her all of the income from date of D's death until her own death. T, trustee, applied for a refund. The recalculation of the tax on which to base the refund is as follows:

X — Sister		
Insurance proceeds	$50,000	
Tax		$3,410.00
Y — Sister (age 62)		
Income on $100,000 x .37165	37,165	
Tax thereon		2,383.20
C — Son		
Tax on remainder—$100,000—$37,165 = $62,835		
Tax thereon		2,150.10
Total Tax		$7,943.30

Refund due—$1,433.86 ($9,377.16—$7,943.30=$1,433.86)

It should be noted that the life estate factor used, .37165 is based upon the age of X, the younger sister, as the sisters were "beneficially entitled in possession or expectancy" to the income for their lives, and their interests were "susceptible of present valuation" at D's death.

EXAMPLE 2: D, by will, bequeathed $100,000 to T in trust to distribute all or part of the income therefrom to X, aged 60, and Y, aged 62, his sisters, in such amounts as T, in his sole discretion, shall determine to be necessary for their maintenance and support. The amount of income not distributed in accordance with the foregoing is to be added to the corpus. Upon the deaths of X and Y, the corpus, plus any undistributed income, is to be surrendered free from trust to C, T's son. X also received taxable

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proceeds of $25,000 from an insurance policy on the life of D. The trustee elects to pay the high tax. The computation is as follows:

Tax to X		
Insurance proceeds	$25,000	
Life estate in $100,000 (trust factor for person aged 60 — .39679)	39,679	
	$64,679	
Tax thereon		$4,877.90
Taxable to C		
$100,000 corpus less life estate of $39,679 or	$60,321	
Tax thereon		$1,999.26
Total high tax		$6,877.16

Three years after D's death, X died. She had received a total of $8,000 in income. Two years after X's death, Y died. She had received a total of $12,000 in income. The combined income received by both sisters was thus $20,000. This income, received by the two sisters during the five-year period beginning with the death of D and ending with Y's death, must be valued as of the date of D's death. During this five-year period, the total income received by the trust was $25,000. Thus, X and Y received $\frac{20,000}{25,000}$ of the income. The factor for income of five years (Table #2) is .158027. Thus, $100,000 x .158027 x $\frac{20,000}{25,000}$ = $12,642.16 (the total income taxed to X and Y). As X received $8,000 ÷ 20,000 or 40% thereof, X will be taxed on $5,056.86, and Y will be taxed on $7,585.30. C is taxed on $100,000 — $12,642.16 or $87,357.84. The tax as computed for the purposes of refund is as follows:

X — Sister		
Insurance proceeds	$25,000.00	
Share of life estate	5,056.86	
Total taxable	$30,056.86	
Tax to X		$1,814.55
Y — Sister		
Share of life estate	$ 7,585.30	
Tax to Y		365.12
C — Son		
Remainderman's share of trust principal	$84,197.30	
Tax to C		3,431.84
Total tax		$5,611.51

The refund is therefore $1,265.65 plus interest at three percent for the period prescribed by law.

EXAMPLE 3: In accordance with a marital deduction clause, $170,000 from the probate estate is added to a $30,000 homestead held jointly by D and W, decedent's widow. D's gross estate is appraised at $450,000, and the

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adjusted gross estate is $400,000. The residue is bequeathed in trust to T under a provision whereby T shall pay the net income to or apply it for the benefit of W for her life. In addition, if no other funds are otherwise available to W, T shall pay to or apply for the benefit of W, from the principal of the trust, from time to time, such amounts as are necessary for her support, maintenance and welfare in accordance with the standard to which she was accustomed during D's lifetime. Upon her death, the remainder shall go in equal shares to each of her four children or to the issue of a deceased child by right of representation. The will further provides that all death taxes attributable to W shall be paid from the residue. The representative elects to pay the high tax.

The high tax computation is as follows:

Total probate estate		$420,000.00	
Less deductions allowable in probate		50,000.00	
		$370,000.00	
Less federal estate tax		31,500.00	
Net probate estate		$338,500.00	
Non-probate joint tenancy	$30,000.00		
Less homestead exemption	30,000.00	—0—	
Total taxable to W		$338,500.00	
High tax			$15,095.00

One year later, W dies. No invasion of the corpus was made in her behalf. T applies for a refund. The recalculation of the tax is as follows:

W, wife, marital deduction share ($200,00 — homestead valued at $30,000)		$170,000.00	
Non-probate joint tenancy	$30,000.00		
Less homestead exemption	30,000.00	—0—	
Total taxable to W		$170,000.00	
Tax thereon			$4,900.00
Tax plus tax on tax		5,157.89	
Life estate in residue (see following for calculation of residue).			
Factor for person aged 65 (age of widow at D's death) .33420 × $163,342.11 =		54,588.93	
Total taxable to W		$229,746.82	
Tax thereon to W			$8,184.81
Taxable to child No. 1 ¼ of $163,342.11 − $54,588.93 = $27,188.29			
Tax thereon to adult child			467.53

Similarly, a tax is calculated for each of the other three children:

Child No. 2	467.53
Child No. 3	467.53
Child No. 4	467.53
Total tax as actually owed	$10,054.93
Total tax under the high tax	$15,095.00

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Subtracting tax actually owed from the high tax of $15,095.00 leaves a balance due of $5,040.07 which will be refunded plus interest at three percent from the date prescribed by law. The residue is computed as follows:

Net probate estate		$338,500.00
Less marital deduction share	170,000.00	
Less tax and tax on tax with respect to property passing to the widow other than that coming from the residue	5,157.89	
		$175,157.89
Residue subject to life estate		$163,342.11

W is entitled to a life estate in residue; therefore, no part of the amount taxable to her attributable to such life estate is subject to tax on tax as the value of her life estate would be increased by tax on tax and correspondingly decreased by the reduced value of the life estate which would result if her tax on tax were deducted therefrom.

EXAMPLE 4: D, by will, bequeathed $50,000 to T in trust to pay the net income to or apply it for the benefit of M, his mother, age 65, for life. In addition, if no other funds are otherwise available to M, T shall pay to, or apply for the benefit of M, from the principal of the trust, from time to time, such amounts as are necessary for her support, maintenance and welfare. Upon her death, the remainder shall go to the First Church. T submits a "composition agreement" (see M.S. § 291.30 and Inh Tax 129) assessing a tax consistent with the terms of the testamentary trust. The Commissioner declines to enter into the composition agreement and insists upon the payment of the highest rate which could possibly be imposed. Consequently, T is required to pay a tax of $1,380, and upon M's death (or her timely disclaimer of the bequest), any unexpended part of the principal will be deducted from the $50,000 value and assigned to the exempt entity (namely the First Church). Thus, if M should die one year after D without any part of the principal being used for her benefit, a refund based upon the following computation would be made:

Value of M's life estate, $50,000 × .33420 = $16,710	
Tax thereon	$214.20
Remainder to First Church ($50,000 − 16,710 = $33,290 tax thereon)	
Total tax due	$214.20

High tax previously paid, $1,380.00. Tax due as re-computed is $214.20; refund, $1,165.80. This refund would bear interest at three percent (see M.S. § 291.11, subd. 5).

Inh Tax 129 Composition Agreements.

(a) In any case where the interest of a beneficiary is subject to one or more contingencies or conditions (as in certain trusts), the occurrence of which may operate to extend, diminish, create or defeat the beneficiary's interest, in whole or in part, the tax may be determined and paid on the assumption that the contingencies or conditions will occur in such a manner as to produce the highest possible tax. A refund may then be obtained when, and to the extent that, subsequent events produce a lower tax than so determined and paid. The two-year limitation as provided by law does not apply in such a case.

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The foregoing often results in delaying final determination of the ultimate tax liability for many years. To eliminate this delay, M.S. § 291.30 permits the Commissioner and persons authorized to act for the estate of the decedent to compute the tax liability with finality. Such an agreement is availed of in many cases and is known as a composition agreement. Where the estate is subject to probate, the composition agreement must be executed in triplicate by the Commissioner and the representative (or by a trustee if a trust with contingent interests is involved). One copy of the composition agreement so executed shall be submitted to the appropriate Probate Court; one copy shall be retained by the Commissioner, and the remaining copy shall be returned to the representative or the trustee.

Where the estate is not subject to probate, the composition agreement must be executed in duplicate by the Commissioner and the trustee. Each of the two parties (the Commissioner and the trustee) shall retain one copy of the executed composition agreement. The representative, or trustee, may submit the appropriate number of copies of the proposed composition agreement to the Commissioner, either at the time he files his inheritance tax return or prior thereto. The required number of copies so submitted shall be signed by the person authorized to execute the composition agreement. If the Commissioner accepts the agreement, he will sign the copies, retain one of such copies for himself, and return the remaining copy to the representative or trustee. If the Commissioner does not agree with the method of taxing the various interests, or if he does not wish to enter into a composition agreement, he will then offer to enter into a composition agreement on the basis of his own calculations, or he will return the proposed composition agreement with a statement that he will impose the "high tax" pursuant to M.S. § 291.11, subd. 5.

Forms IG-100 and 100a have been prescribed by the Commissioner for composition agreements, and are available upon request.

(b) No absolute requirement is imposed either upon the Commissioner or upon the representative (or trustee) to enter into a composition agreement. Under M.S. § 291.11, subd. 5, the Commissioner may impose the highest tax possible consistent with the governing instrument, or the representative (or trustee) may elect to pay the highest tax possible, consistent with the governing instrument. If such high tax is paid, upon the final vesting of the interest involved, a recomputation may be made, and a petition for refund of the amount of tax over-paid may be submitted (see Inh Tax 128 for refund procedures).

(c) The tax, as compounded (this means under a composition agreement) shall be computed upon terms that are "equitable and expedient". In addition, such a composition agreement is final in respect of the interests of the various beneficiaries subject thereto, and of the property described therein, unless otherwise stipulated. The following example is illustrative:

D's will creates a testamentary trust with a value of $200,000. The trust provides for income for life to his sister, S, aged 70, with remainder over to his two adult children. In addition, the trust provides that the trustee may, from time to time, pay to or apply for the benefit of S, such amounts from the trust principal as the trustee deems necessary or advisable for her care, comfort, support, maintenance or welfare.

The interest taxable to S is dependent, in part, upon the amount of principal that is withdrawn for the support, maintenance, etc., for the benefit of

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S. Conversely, the taxable interests of D's two children are unascertainable until S's death occurs, as they are entitled to only that share of the principal of the trust unexpended at S's death. Consequently, two assumptions may be incorporated in a composition agreement: (1) The assumption which produces the highest possible tax; that the entire trust principal will be expended for S's benefit; (2) The assumption which produces the lowest possible tax; that no part of the trust principal will be withdrawn for her benefit.

Under the first assumption, the entire trust principal is assigned to S. The tax thereon, described as the "high tax" is computed as follows: S, sister, $200,000; tax thereon, $21,410.

Under the second assumption, S's share is the value of the life estate, as she is entitled to the income for life. However, no part of the trust principal is taxed to her. This is the low tax and is computed as follows:

Life estate for person aged 70 (see Table 1 of Inh Tax 126) .27370 × $200,000 = $54,740; tax thereon — $3,884.00.

Under the first assumption, the two children receive —0—. Therefore, the tax is zero. Under the second assumption, the amount taxable to each child is one-half of $200,000, less $54,740, or $72,630. The tax to each child on $72,630 is $2,737.80.

Thus, the tax as finally computed for the composition agreement is as follows:

	High Tax	Low Tax	Total	Composition Agreement
Sister	$21,410.00	$3,884.00	$25,294.00	$12,647.00
Child 1	—0—	2,737.80	2,737.80	1,368.90
Child 2	—0—	2,737.80	2,737.80	1,368.90
	$21,410.00	$9,359.60	$30,769.60	$15,384.80

Inh Tax 130 Taxation of Reversionary Interests.

(a) Under M.S. § 291.11, subd. 8, where the value of any devise, bequest, legacy or gift cannot be determined by reason of a contingency or future event, the tax thereon shall not become due and payable until the person or beneficiary entitled thereto shall come into actual possession or enjoyment thereof. The application of this section does not apply to any contingency regarding the identity of the beneficiary but is limited to contingencies which prevent valuing the interest as of the date of decedent's death.

(b) Pursuant to M.S. § 291.11, subd. 9, where the value of an estate cannot be ascertained by reason of a contingency or limitation, the property shall be appraised at its full and true value at the time the contingency or limitation is removed, and the tax assessed against the beneficiary entitled thereto at that time. The tax imposed on such beneficiary shall be based upon his relationship to the decedent from whom he received the property.

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CHAPTER THIRTEEN: INH TAX 136-140
VALUE OF CERTAIN TRANSFERS MADE BY DECEDENT DURING LIFETIME

Inh Tax 136 Certain transfers of property made by the decedent during his lifetime are includible in his estate for inheritance tax purposes in the same manner and at the same values as would be the case had the property been an asset of decedent's estate at the time of his death. Unless made for adequate and full consideration in money or money's worth, the following transfers made by the decedent during his lifetime are subject to M.S. § 291.11, subd. 7:

(1) Transfers in contemplation of death;
(2) Transfers with a retained life estate;
(3) Transfers taking effect at death;
(4) Transfers subject to revocation by decedent.

The following examples are illustrative:

EXAMPLE 1: F, grantor, on July 1, 1962, made an irrevocable transfer of securities valued at $200,000 to T, trustee. F retained the income for life with remainder to be paid to S, his son, at F's death. F dies on June 1, 1969. At the time of his death, the securities subject to the trust have a market value of $350,000. An inheritance tax will be assessed against S based upon the $350,000 value of the trust assets. However, See Inh Tax 137 with reference to the credit for gift tax paid.

EXAMPLE 2: X, grantor, aged 60, after retaining the income for life from Blackacre for himself, conveyed the remainder to S, his son, on July 1, 1962. At the time of the conveyance, the value of Blackacre was $50,000. A gift tax return was duly filed, and the tax paid. S dies on July 5, 1967, and by will devised his remainder interest in the property in equal shares to his wife and his two children. At the time of S's death, Blackacre was valued at $60,000, and the value of X's life estate, as computed as of the date of S's death, was $60,000 × .33420 or $20,052. Thus, S's remainderman's interest at his death was valued at $39,948. On July 15, 1969, X died. At that time, Blackacre had a fair market value of $75,000. The value at date of death, namely $75,000, will be taxed on the basis of the relationship between X and his remainderman, S, despite the prior decease of the latter. The tax on $75,000 to an adult son is $2.880. This tax will be reduced by the gift tax paid by X. See Inh Tax 137 for credit for gift tax paid.

EXAMPLE 3: F, grantor, aged 50, after retaining the income for life from Whiteacre, conveyed the remainder to C-1, C-2 and C-3, his three children. At the time of the transfer, C-1 and C-2 were adults, and C-3 was a minor. At that date, February 1, 1955, Whiteacre was worth $60,000. C-1 died on June 5, 1965, and by will devised his remainderman's interest to C-2 and C-3 who paid the inheritance tax due on the market value of ⅓ the remainder after giving effect to F's life estate. (See Example 2 above) On December 10, 1968, C-2 dies, and by will devised his remainderman's interest to C-3 who paid the inheritance tax due on the market value of ⅓ the remainder after giving effect to F's life estate. On April 15, 1969, C-3 dies and by will devised his remainder interest to S, a stranger, who pays an inheritance tax on the market value of Whitacre as of that date after giving effect to F's life estate. On June 15, 1969, F dies. The market value of Whiteacre at the date of F's death was $150,000. The tax will be assessed on the relationship between F and the three original remaindermen (C-1, C-2 and C-3) as if they had survived F. Consequently, the inheritance tax will be assessed

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on the basis of $50,000 passing to each of the original remaindermen, **and at the rates and exemptions applicable to three adult children.** It should be noted here that although C-3 was a minor at the time of the original conveyance, nevertheless, at F's death, had he survived, he would have been an adult. (See Example 2 for credits applicable).

EXAMPLE 4: F, grantor, aged 50, after retaining the income from Modern Apartment Complex for himself, conveys the remainder to S, his son. The fair market value at the time of transfer was $500,000. F's life estate is valued at $259,850, and a gift tax is paid on the remainder of $240,150. F and S retained the fee until F's death and the property at that time was valued at $1,000,000. S is subject to an inheritance tax based upon the $1,000,000 value.

Inh Tax 137 Credit for Gift Taxes Previously Paid. Where the value of the property taxable to a beneficiary includes property previously taxed as a gift to such person, the inheritance tax imposed on such beneficiary shall be credited with the amount attributable to the inclusion of the property subject to the gift. See M.S. § 292.14.

The amount of the credit shall be the lesser of the gift tax actually paid on the gift, or an amount that bears the same relationship to the inheritance tax paid by or on behalf of such beneficiary, as the value of the gift included in the amount taxable bears to the total amount of taxable property (including the gift) passing to such beneficiary. The following examples are illustrative:

EXAMPLE 1: F, donor, made a gift of property valued at $100,000 to S, his adult son on December 1, 1968. No prior gifts had been made by F to S. F filed a gift tax return and paid a tax of $4,200 ($4,220 less $20 credit) F died on April 20, 1969, leaving property taxable to S in the amount of $200,000. The Commissioner determined that the gift made on December 1, 1968, was in contemplation of death and included the $100,000 in the taxable estate. The computation of the tax and credit allowed is as follows:

Total taxable to S	$300,000	
Tax thereon		$ 19,380
Maximum credit allowable		
$\frac{100,000}{300,000} \times 19,380 = \$6,460$ (inheritance tax)		
Tax paid on gift — $4,200		
Amount allowed as credit		4,200
Tax due		$ 15,180

EXAMPLE 2: F, aged 70, conveyed the remainderman's interest on Blackacre to D, his adult daughter, and reserved for himself the income therefrom for life. Blackacre was valued at $100,000. D's remainder interest is valued at $72,630. Previous gifts to D amounted to $500,000. F files a gift tax return reflecting a tax of $6,536.70. Upon F's death, D receives taxable insurance proceeds of $30,000. Blackacre, which is valued at $120,000 at date of F's death, is included in the amount taxable to D. Total taxable to D is thus $120,000 + $30,000 or $150,000. The credit for gift taxes allowable is computed as follows:

$\frac{\$120,000 \text{ (value of gift included)}}{\$150,000 \text{ (total value taxable to D)}} \times \$7,880 \text{ (inheritance tax)} = \$6,040 \text{ (credit)}$

Consequently, the inheritance tax due in respect of D is $7,880 − $6,040 or $1,840.

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CHAPTER FOURTEEN: INH TAX 141-152

INHERITANCES — HOW APPRAISED

Inh Tax 141 In General. M.S. § 291.23 provides that every inheritance, devise, bequest, legacy, transfer, or gift subject to tax under Chapter 291 shall be appraised at its full and true value immediately upon the death of the decedent, or as soon thereafter as may be practicable. However, if its full and true value cannot be ascertained at such time, it shall be appraised at the time the value first becomes ascertainable. This general rule has been modified by the 1963 Minnesota Legislature. Where death occurs on or after July 1, 1963, and where a federal estate tax return is filed and an election is made under the provisions of section 2032 of the Internal Revenue Code to use the alternate valuation date for federal estate tax purposes, then every inheritance, devise, bequest, legacy, transfer, or gift subject to Minnesota inheritance taxes under the provisions of M.S. Chapter 291 shall be valued as of the applicable federal valuation date or dates. The use of the alternate valuation method for purposes of valuing the assets subject to the provisions of M.S. Chapter 291 will not be allowed unless the election to so value the federal estate tax return was made in accordance with federal laws and regulations.

The application of the alternate valuation provision is subject to the time limitations imposed by M.S. § 291.21, or M.S. § 291.09, depending upon whether the proceedings before the probate court or the Commissioner of Taxation were instituted prior to January 1, 1964 or at a date subsequent.

Where the proceedings are subject to M.S. § 291.21, Laws of 1961 an objection must be filed with the probate court to the valuations shown in the inventory and appraisal within 90 days after filing the inventory with the Commissioner. Such objection can be made by either the Commissioner or an interested party.

The non-probate assets, irrespective of whether there are probate proceedings involved or otherwise, will be valued as provided in M.S. § 291.23, unless the time limitation imposed by M.S. § 291.11 precludes a determination of tax based upon the alternate values.

Under the provision of M.S. § 291.11, Subd. 1 (c) Laws of 1961, the Commissioner and the taxpayer may enter into an agreement to extend the period of limitations imposed by subchapters (a) and (b) of this subdivision. Such an agreement will authorize the use of the alternate values where applicable under M.S. § 291.23, Laws of 1963.

Where the provisions of Chapter 740, Session Laws of 1963 are affected, M.S. § 291.09, Subd. 1 provides that the values shown on the inventory and appraisal, and schedule of non-probate assets required to be filed with the probate court shall be final unless an objection is entered within 90 days. A similar provision is contained in subdivision 2 of this section in the case where no probate proceedings are involved.

However, subdivision 5 of this section reads as follows:

"Notwithstanding other provisions of this Chapter, when agreed in writing between the Commissioner and the representative, values for purposes of the inheritance tax on both probate and non-probate assets shall be the same as those finally determined for purposes of the federal estate tax on a decedent's

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estate." This agreement to follow the federal is authorized by M.S. § 291.11, Subd. 1 (c).

Thus, the representative of the estate who institutes probate proceedings prior to the expiration of the period authorizing the use of the alternate values under Section 2032 of the Internal Revenue Code may insure the use of such values for Minnesota inheritance tax purposes by executing the agreement as provided in M.S. § 291.11.

As stated above M.S. § 291.23 is effective only in the case where death occurred on or after July 1, 1963.

Inh Tax 142 Valuation of stocks and bonds.

(a) Based on selling prices. If there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share or bond. If there were no sales on the valuation date, but there were sales on dates within a reasonable period both before and after the valuation date, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales on the nearest date before and the nearest date after the valuation date. The average is to be weighted inversely by the respective numbers of trading days between the selling dates and the valuation date. For example, assume that sales of stock nearest the valuation date (Friday, June 15) occurred two trading days before (Wednesday, June 13) and three trading days after (Wednesday, June 20) and that on these days the mean sale prices per share were $10 and $15, respectively. The price of $12 is taken as representing the fair market value of a share of the stock as of the valuation date $\frac{((3 \times 10) + (2 \times 15))}{(\quad 5 \quad)}$. If, instead, the mean sale prices per share on June 13 and June 20 were $15 and $10, respectively, the price of $13 is taken as representing the fair market value $\frac{((3 \times 15) + (2 \times 10))}{(\quad 5 \quad)}$. As a further example, assume that the decedent died on Sunday, October 7, and that Saturday and Sunday were not trading days. If sales of stock occurred on Friday, October 5, at mean sale prices per share of $20 and on Monday, October 8, at mean sale prices per share of $23, then the fair market value per share of stock as of the valuation date is $21.50. If stocks or bonds are listed on more than one exchange, the records of the exchange where the stocks or bonds are principally dealt in should be employed. In valuing listed securities, the executor should be careful to consult accurate records to obtain values as of the applicable valuation date. If quotations of unlisted securities obtained from brokers, or evidence as to their sale is obtained from officers of the issuing companies, copies of the letters furnishing such quotations or evidence of sale should be attached to the return.

(b) Based on bid and asked prices. If the provisions of paragraph (a) of this section are inapplicable because actual sales are not available during a reasonable period beginning before and ending after the valuation date, the fair market value may be determined by taking the mean between the bona fide bid and asked prices on the valuation date, or if none, by taking a weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the valuation date, if both such nearest dates are within a reasonable period. The

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average is to be determined in the manner described in paragraph (a) of this section.

(c) Based on incomplete selling prices or bid and asked prices. If the provisions of paragraphs (a) and (b) of this section are inapplicable because no actual sale prices or bona fide bid and asked prices are available on a date within a reasonable period before the valuation date, but such prices are available on a date within a reasonable period after the valuation date, or vice versa, then the mean between the highest and lowest available sale prices or bid and asked prices may be taken as the value.

(d) Where selling prices or bid and asked prices are unavailable. If the provisions of paragraphs (a), (b), and (c) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

(e) Pledged securities. The full value of securities pledged to secure an indebtedness of the decedent is included in the gross estate. If the decedent had a trading account with a broker, all securities belonging to the decedent and held by the broker at the date of death must be included at their fair market value as of the applicable valuation date. Securities purchased on margin for the decedent's account and held by a broker must also be returned at their fair market value as of the applicable valuation date. The amount of the decedent's indebtedness to a broker or other person with whom securities were pledged is allowed as a deduction from the gross estate in accordance with the provisions of M.S. § 291.07 and the regulations applicable thereto.

(f) Securities subject to an option or contract to purchase. Another person may hold an option or a contract to purchase securities owned by a decedent at the time of his death. The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case. Little weight will be accorded a price contained in an option or contract under which the decedent is free to dispose of the underlying securities at any price he chooses during his lifetime. Such is the effect, for example, of an agreement on the part of a shareholder to purchase whatever shares of stock the decedent may own at the time of his death. Even if the decedent is not free to dispose of the underlying securities at other than the option or contract price, such

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price will be disregarded in determining the value of the securities unless it is determined under the circumstances of the particular case that the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth.

(g) Stock sold "ex-dividend." In any case where a dividend is declared on a share of stock before the decedent's death but payable to stockholders of record on a date after his death and the stock is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the stock as of the date of the decedent's death.

EXAMPLE 1: Dividend of $1 declared Jan. 1, 1962 to be paid to stockholders of record on Jan. 5, 1962 and actually received Jan. 12, 1962. The $1 dividend is included in the gross estate as a separate asset because the record date is prior to the date of death.

EXAMPLE 2: Dividend of $1 declared January 4, 1962 to be paid to stockholders of record on January 12, 1962 and actually received by the estate on Jan. 15, 1962. The stock was selling ex-dividend on date of death. The dividend is added to the stock quotation and is included in the gross estate. Although the stockholder of record date is after the date of death the dividend is included because the fair market value of the stock is not accurately reflected when it sells ex-dividend.

Inh Tax 143 Valuation of interests in businesses. The fair market value of an interest of a decedent in a business, whether a partnership or a proprietorship, is the net amount which a willing purchaser, whether an individual or a corporation, would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The net value is determined on the basis of all relevant factors including —

(a) A fair appraisal as of the applicable valuation date of all the assets of the business, tangible and intangible, including good will;

(b) The demonstrated earning capacity of the business; and

(c) The other factors set forth in Inh Tax 100, (d) and (f) relating to the valuation of corporate stock, to the extent applicable.

Special attention should be given to determining an adequate value of the good will of the business in all cases in which the decedent has not agreed, for an adequate and full consideration in money or money's worth, that his interest passes at his death to, for example, his surviving partner or partners. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of examinations of the business made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

Inh Tax 144 Valuation of notes. The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus interest accrued to the date of death, unless the executor establishes that the value is lower or that the notes are worthless. However, items of interest shall be separately stated on the estate tax return. If not returned at face value, plus accrued interest, satisfactory evidence must be submitted that the note is worth less than the unpaid amount (because of the interest rate, date of

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maturity, or other cause), or that the note is uncollectible, either in whole or in part (by reason of the insolvency of the party or parties liable, or for other cause), and that any property pledged or mortgaged as security is insufficient to satisfy the obligation.

Inh Tax 145 Valuation of cash on hand or on deposit. The amount of cash belonging to the decedent at the date of his death, whether in his possession or in the possession of another, or deposited with a bank, is included in the decedent's gross estate. If bank checks outstanding at the time of the decedent's death and given in discharge of bona fide legal obligations of the decedent incurred for an adequate and full consideration in money or money's worth are subsequently honored by the bank and charged to the decedent's account, the balance remaining in the account may be returned, but only if the obligations are not claimed as deductions from the gross estate.

Inh Tax 146 Valuation of household and personal effects. General Rule. The fair market value of the decedent's household and personal effects is the price which a willing buyer would pay to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. A room by room itemization of household and personal effects is desirable. All the articles should be named specifically, except that a number of articles contained in the same room, none of which has a value in excess of $100, may be grouped. A separate value should be given for each article named. In lieu of an itemized list, the executor may furnish a written statement, containing a declaration that it is made under penalties of perjury, setting forth the aggregate value as appraised by a competent appraiser or appraisers of recognized standing and ability, or by a dealer or dealers in the class of personalty involved.

Inh Tax 147 Valuation of annuities, life estates, terms for years, remainders and reversions. The fair market value of annuities, life estates, terms for years, remainders and reversions is their present value, determined under tables issued by the Commissioner of Internal Revenue. The use of these tables is authorized by M.S. § 291.11, sub. 2. For actual calculations see "Actuarial Values for Estate and Gift Tax". This pamphlet may be purchased at a nominal sum from the Superintendent of Documents, United States Government Printing Office, Washington 25, D.C.

Inh Tax 148 Valuation of certain life insurance and annuity contracts.

(a) The value of a contract for the payment of an annuity, or an insurance policy on the life of a person other than the decedent, issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts. An annuity payable under a combination annuity contract and life insurance policy on the decedent's life (e.g., a "retirement income" policy with death benefit) under which there was no insurance element at the time of the decedent's death is treated like a contract for the payment of an annuity for purposes of this section.

(b) As valuation of an insurance policy through sale of comparable contracts is not readily ascertainable when, at the date of the decedent's death, the contract has been in force for some time and further premium payments are to be made, the value may be approximated by adding to the interpolated terminal reserve at the date of the decedent's death the proportionate part of the gross premium last paid before the date of the decedent's death which covers the period extending beyond that date. If,

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however, because of the unusual nature of the contract such an approximation is not reasonably close to the full value of the contract, this method may not be used.

(c) The application of this section may be illustrated by the following examples. In each case involving an insurance contract, it is assumed that there are no accrued dividends or outstanding indebtedness on the contract.

EXAMPLE 1: X purchased from a life insurance company a joint and survivor annuity contract under the terms of which X was to receive payments of $1,200 annually for his life and, upon X's death, his wife was to receive payments of $1,200 annually for her life. Five years after such purchase, when his wife was 50 years of age, X died. The value of the annuity contract at the date of X's death is the amount which the company would charge for an annuity providing for the payment of $1,200 annually for the life of a female 50 years of age.

EXAMPLE 2: Y died holding the incidents of ownership in a life insurance policy on the life of his wife. The policy was one on which no further payments were to be made to the company (e.g., a single premium policy or a paid-up policy). The value of the insurance policy at the date of Y's death is the amount which the company would charge for a single premium contract of the same specified amount on the life of a person of the age of the insured.

EXAMPLE 3: Z died holding the incidents of ownership in a life insurance policy on the life of his wife. The policy was an ordinary life policy issued nine years and four months prior to Z's death and at a time when Z's wife was 35 years of age. The gross annual premium is $2,811 and the decedent died four months after the last premium due date. The value of the insurance policy at the date of Z's death is computed as follows:

Terminal reserve at end of tenth year	$14,601.00
Terminal reserve at end of ninth year	12,965.00
Increase	1,636.00
One-third of such increase (Z having died four months following the last preceding premium due date) is	$ 545.33
Terminal reserve at end of ninth year	12,965.00
Interpolated terminal reserve at date of Z's death	13,510.33
Two thirds of gross premium (⅔ × $2,811)	1,874.00
Value of the insurance policy	$15,384.33

Inh Tax 149 Valuation of other property. The valuation of any property not specifically described in this regulation shall be made in accordance with the general principles set forth in these regulations.

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CHAPTER FIFTEEN: INH TAX 153-170
DEDUCTIONS

Inh Tax 153 Deduction. M.S. § 291.07, subd. 1, lists the deductions allowable where an estate has been submited to probate. Subdivision 2 lists the deductions allowable where an estate has not been submitted to probate. There may be instances where the deductions allowable will be permitted to be taken against non-probate assets, although there are probate assets available for payment of the charges. In other instances, deductions for such charges may only be allowed against probate assets to the extent of the probate assets. Each of these deductions will be treated as a separate regulation.

All inheritance tax deductions must be supported by evidence sufficient to establish both the validity and the correctness thereof, if such evidence is requested by the Probate Court in the case of probate assets, or the Commissioner in the case of non-probate assets.

Under M.S. § 291.09, subd. 1(c), the determination of inheritance tax deductions in respect of probate assets is to be made by the Probate Court, subject to the right of the Commissioner to object to such determination as therein provided. The determination of deductions in respect of non-probate assets is to be made by the Commissioner under M.S. § 291.09, subd. 2(b). Appeals from a determination by the Probate Court or by the Commissioner may be taken as provided by law.

Inh Tax 154 Funeral Expenses.

(a) Funeral expenses are primarily payable out of probate assets since they are estate liabilities. Therefore, to the extent that there are probate assets which can be applied to the payment of funeral expenses, consistent with the priority established under M.S. § 525.44, such expenses must be paid out of probate assets in order to qualify for the inheritance tax deduction.

EXAMPLE: H's will bequeathed his entire probate estate to W, his wife. In addition, H and his son, S, were the joint owners of bank accounts in the amount of $50,000. As H had furnished all the consideration for these bank accounts, the entire $50,000 is taxable to S. S paid H's funeral expenses of $2,000. As there are sufficient probate assets from which to pay such funeral expenses, S will not be allowed a deduction against the non-probate assets (the $50,000 in bank deposits) transferred to him at H's death. However, if S files a claim for reimbursement against the probate estate, and if such reimbursement is made to him, the deduction will be allowed against the probate assets passing to W.

(b) Where the probate assets available are insufficient to pay the funeral expenses, the deduction will be allowed to a beneficiary of non-probate assets provided such beneficiary actually pays the difference between the funeral expenses and the amount of probate assets available for such payment.

EXAMPLE: The probate assets available for funeral expenses are $500. Expenses to be paid are $1,200. B, who received $30,000 in taxable insurance proceeds, payable at death of decedent, makes payment of the deficit of $700. B will be allowed a deduction of $700 against the insurance proceeds taxable to him.

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(c) Expenditures incident to the funeral service, such as undertakers' charges, clergymen's fees, expenses for music or flowers, cemetery lots, tombstones (where authorized by the Probate Court) charges for preparing the grave site, etc., are allowable. Expenses incurred for purposes not directly connected with the funeral service, for example, the cost of meals and food served after the funeral, or expenses of travel to the funeral, are not allowable. (The cost of the limousine furnished by the undertaker for the use of the family does not constitute an expense of traveling to the funeral.)

(d) If any beneficiary, other than the surviving spouse, is the recipient of a Social Security payment for funeral expenses, the amount of the inheritance tax deduction for funeral expenses shall be reduced to the extent of such payment received.

Inh Tax 155 Probate Administration Expenses.

(a) Probate administration expenses are only deductible for inheritance tax purposes to the extent that they are paid out of probate assets, and the deduction for probate administration expenses is available ratably to those beneficiaries whose interest in the decedent's estate are reduced by such payments.

(b) The following items are regarded as probate administration expenses and are allowable:

(1) Appraisers' fees, preparation of orders, certified copies, bond premiums, expenses incurred by the representative or his agent, postage, stock transfer expense, and expenses incident to sale of real or personal property in the hands of the representative, where a sale is necessary to pay specific legacies or other expenses of administration.

(2) Compensation of representative's and attorney's fees as provided by statute:

> "Every representative . . . shall have such compensation for his services as the Court shall deem just and reasonable."

The fact that the representative is himself a lawyer does not imply that in addition to conducting administration of the estate, he shall perform any required legal service gratis. An executor who champions a will in good faith and for just cause for the purpose of having it admitted to probate, whether successful or not, shall be allowed out of the estate his necessary expenses and disbursements in such proceeding, together with just compensation for his services and those of his attorneys, as the Court shall deem just and proper. An attorney performing services for the estate at the instance of the representative shall have such compensation therefor out of the estate as the Court shall deem just and reasonable. If any person successfully opposes the allowance of any will or codicil, he is allowed his expenses and compensation for services of himself and attorney. Where a controversy is settled, which does not result in the disallowance of the will or of a disputed codicil, attorney's fees incurred by the claimant shall not be allowed as a deduction.

EXAMPLE: K died testate leaving the major portion of his estate to four charities. His only heir at law was an aunt, who subsequent to his decease died intestate in Illinois, survived by her husband and child. Had K died intestate, his entire estate would have passed to his aunt and would have been an asset in her estate at her death. Following expiration of the

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time for appeal, the representative of the estate of the deceased aunt hired counsel to contest the will of K, under a contingent fee arrangement whereby the attorneys were to receive 50 percent of any amount recovered by reason of the will contest. A compromise agreement was reached whereby the four charities which were beneficiaries under the will of K agreed to contribute the sum of $12,500 each to the representative of the deceased aunt's estate. The settlement was approved by the probate court, and an order was made for a partial distribution to the four charities of amounts required to pay the administrator of the deceased aunt's estate. As K's will was not disallowed, the entire $50,000 was taxed to the deceased aunt without any deduction for attorneys' fees.

(3)(i) In general, where assets are sold during administration at less than the values as determined under the provisions of M.S. §§ 291.09 and 291.23 in order to raise cash to pay specific legacies or to defray the expenses of administration and death taxes, in those cases where the required funds would otherwise be unavailable, any loss resulting from such disposition is an allowable deduction subject to the limitations of subparagraphs 3(ii) and 3(iii) of this Regulation. However, it should be noted that M.S. § 290.01, subd. 20(d), does not allow such a loss in computing the taxable income of the estate unless there is filed a waiver of the right to take the deduction for inheritance tax purposes. Under M.S. § 525.63, the real estate is subject to payment of expenses of administration only where the personal property is insufficient for this purpose.

EXAMPLE: X's will contained bequests totalling $100,000 in cash to certain designated beneficiaries. All death taxes are to be paid from residue. After taking into account the cash on hand, the executor determined that he would require an additional $300,000 in order to pay the specific legacies and to defray the expenses of administration. He realized $300,000 on the sale of assets which had been valued for inheritance tax purposes at $315,000. The $15,000 difference between the appraised value of the assets so disposed, and the amount realized is an allowable deduction.

(ii) Where assets are sold in order to defray expenses of administration, and the amount realized is greater than the amount required, the allowable amount of any loss that may be incurred thereby shall be computed by multiplying the amount of the loss so incurred by a fraction, the numerator of which is the amount required, and the denominator is the amount realized.

EXAMPLE: X's will contains bequests totalling $100,000 in cash to certain designated beneficiaries. All death taxes are to be paid from residue. After taking into account the cash on hand, the executor determined that he required an additional $300,000 in order to pay the specific legacies and to defray the expenses of administration. He realized $325,000 on the sale of assets which had been valued for inheritance tax purposes at $338,000, thus incurring a loss of $13,000. The allowable deduction is computed as follows:

Amount required $\frac{\$300{,}000}{325{,}000} \times \$13{,}000$ (loss) = $12,000 (deduction allowed)

(iii) Where assets must be sold to raise expenses of administration, and such assets cannot be subdivided or sold piecemeal, the loss represented by the difference between the appraised value for inheritance tax

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purposes and the proceeds of such sale will be allowed in its entirety providing there is a reasonable relationship between the asset so disposed and the amount of cash required for the purpose of administration. The following examples are illustrative:

EXAMPLE 1: The expenses of administration of the estate of X are $15,000. In order to realize sufficient cash, the executor sells an apartment house which is part of the residue of $35,000 and incurs a loss of $5,000. The loss is deductible as an expense of administration.

EXAMPLE 2: The expenses of administration of the estate of X are $25,000. Although there are assets available in the residue, the sale of which would yield the approximate amount required, the executor sells Blackacre which has an appraised value of $210,000 for $150,000. The allowable loss is $10,000 computed as follows:

$$\text{Amount required } \frac{\$\ 25{,}000}{\text{Amount realized } 150{,}000} \times \$60{,}000 \text{ (loss incurred)} = \$10{,}000 \text{ (deduction allowed)}$$

(iv) Where part of the decedent's estate consists of assets not subject to the provisions of Chapter 291, the allowable loss incurred by the sale of assets required to raise the funds necessary to defray the expenses of administration shall be determined by multiplying the amount of the loss by a fraction, the numerator of which is the amount required for Minnesota expenses of administration, and the denominator, the total amount realized.

EXAMPLE: The value of X's estate is equally divided between property taxable by Minnesota and real estate having its situs outside of Minnesota. The expenses of administration assignable to Minnesota amount to $40,000, while the expenses outside Minnesota are $10,000. There are no specific legacies payable from the estate subject to Minnesota inheritance tax. Federal estate taxes total $100,000, half of which are attributable to the property taxable to Minnesota. There is no marital deduction. In order to pay the expenses of administration, the executor realizes $150,000 on the sale of assets appraised at $180,000. The $18,000 loss allowable as a deduction is computed as follows:

$$\frac{\$40{,}000 + 50{,}000 \text{ (½ the federal estate tax)}}{\$150{,}000} \times \$30{,}000 = \$18{,}000 \text{ (allowable deduction)}$$

(v) Where personal property in an amount equal to requirements is sold at a loss, and the proceeds so realized are used for the required purposes, and thereafter, sales of other personal property are made at a gain, the loss so incurred shall not be off-set against the subsequent gain.

EXAMPLE 1: The expenses of administration of the estate of D are $30,000. In order to realize sufficient funds, shares of X stock valued at $40,000 are sold at $30,000. The proceeds so realized are then utilized to pay the required expenses. Subsequent to the payment of such expenses, Y stock, valued at $50,000, is sold at $70,000. The executor is not required to off-set the $10,000 loss allowable as an expense of administration on his inheritance tax return against the gain realized on the sale of Y stock.

EXAMPLE 2: Same facts as Example 1. However, the expenses of administration are paid subsequent to the sale of both X and Y stocks. Under these circumstances, the loss will not be allowed as an expense of administration on the Minnesota inheritance tax return.

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Inh Tax 156 Expenses of Last Illness Unpaid at Death.

(a) Expenses of last illness are allowable as a deduction if unpaid at death. Inasmuch as such expenses are a direct charge against the assets of the decedent (probate assets), they are primarily payable out of the probate estate, consistent with the provisions of M.S. § 525.44. Should the probate assets be insufficient to pay such expenses, a beneficiary of non-probate assets will be entitled to take the deduction provided he has actually paid such expenses of illness subsequent to decedent's death. The Commissioner may request proof of payment by such beneficiary before allowing the deduction.

Unreimbursed disbursements for expenses of illness paid by any person prior to death of decedent constitute claims against the decedent which must be filed with the Probate Court pursuant to M.S. § 525.41 et seq., M.S. § 291.07, and Inh Tax 157.

Inh Tax 157 Claims Against the Decedent.

(a) The inheritance tax deduction for claims against the decedent is confined to claims "which have been properly filed and allowed as such by the probate court and duly paid". Thus, claims are only deductible for inheritance tax purposes to the extent that they are paid out of probate assets. The determination of the inheritance tax in respect of claims against the decedent is to be made by the probate court subject to the right of the Commissioner to object to such determination.

(1) Where the Commissioner objects to a claim against the decedent represented by services purported to have been performed by the claimant in the past, the claimant may, if he so chooses, submit evidence to the Commissioner prior to the hearing on the objections before the Probate Court (see M.S. § 291.09, subd. 1 (c)). The Commissioner will give weight to an affidavit by claimant that, to the extent of the amount of the claim allowed and paid to him, he will include such income on his Minnesota income tax return.

(2) An ante-nuptial agreement, under which the surviving spouse is entitled to a specific amount or a specified share of the estate, does not constitute a claim against the decedent, but is a contract which substitutes the terms contained therein for the statutory rights of the surviving spouse pursuant to M.S. § 525.15.

(3) Any property claimed by the surviving spouse under Section 525.16(2) and (3), does not represent a claim against the decedent.

(4) A promise by the decedent to pay a specified amount at some future date does not represent a claim against the decedent unless given in return for "adequate and full consideration in money or money's worth". The Commissioner will enter his objections to such claims, unless made for adequate consideration.

(b) Claims duly paid. Laws 1965, Chapter 249, added the phrase "and duly paid" to M.S. § 291.07(4). Thus, claims have to be paid in a proper manner, that is, properly as distinguished from mere form, both according to law and to substance. Payment of a claim that does not result in a diminution of the amount taxable to one or more of the beneficiaries does not constitute a claim "duly paid". A voluntary contribution made by a beneficiary of non-probate assets to the representative in order to furnish

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the latter with sufficient funds to pay claims properly filed and allowed with the Probate Court will be allowed by the Commissioner as a deduction against the non-probate assets passing to such beneficiary.

(c) Mortgages, encumbrances, etc. M.S. § 525.331 provides that all encumbrances, liens and charges against any items of inventory in the estate of the decedent shall be deducted from the value of the property in order to arrive at the net value. Although M.S. Chapter 291 does not contain a similar provision, the Commissioner does permit the beneficiary to deduct from the value of the non-probate property passing to him the mortgages, liens and charges against such property, in order to treat the taxation of such property in the same manner as probate property is treated.

If the encumbrance, lien or charge against an item of property in the estate of the decedent is in excess of the value of the property, the excess shall be considered a claim against the decedent, provided he is personally liable for such deficit.

Where the decedent was personally liable for the amount of the mortgage, and at the date of his death, the value of the property was in excess of the amount so owed, the mortgage note does not constitute a claim against the decedent. Consequently, if the representative pays the entire amount due on the mortgage, the amount so paid will be disallowed as a claim against the decedent.

EXAMPLE: H, at his death, held Blackacre as homestead in joint tenancy with W, his wife. At the inheritance tax valuation date, the fair market value thereof was $40,000, and the property was subject to a $20,000 mortgage in favor of X Bank. H had signed a note imposing personal liability on him for the amount of the mortgage. The representative paid the $20,000 mortgage. The $20,000 so paid does not represent a claim against the decedent as the value of Blackacre is in excess of the encumbrance. Blackacre passed to the surviving spouse subject to the mortgage, consequently, the value of Blackacre, for inheritance tax purposes, was reduced by the amount of the mortgage. The effect of the representative's actions is to substitute for $20,000 in cash given to X bank, a $20,000 mortgage which now becomes an asset of the estate.

Inh Tax 158 Family Maintenance. Under M.S. § 525.15 (4), the Probate Court has discretion to allow reasonable maintenance to the spouse or children of the decedent for a period not to exceed 18 months. If the estate is insolvent, that is, if the probate estate is insufficient to pay all of the debts of the decedent (see M.S. § 525.44), the statute limits the period to twelve months. Family maintenance is limited to assets or income of the probate estate. Although not precisely spelled out in the statute, family maintenance may be deemed to be an expense of administration thus taking precedence over items 2 through 6, M.S. § 525.44. However, in order to protect the interests of persons entitled to payment under 2 through 6, the statute does limit reasonable maintenance to a period of not more than twelve months when the estate is insolvent.

Under M.S. § 291.10, the deduction allowed by M.S. § 291.07 for maintenance is limited to the amount allowed by the Probate Court for one year and actually paid, or to $5,000, whichever is the lesser amount. However, M.S. § 291.05(3) and (4), and Inh Tax 180 provide an exemption from tax to the widow or to minor children in those cases where maintenance allowed is less than $5,000 or where there is no probate involved.

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The Commissioner will not allow a deduction against non-probate assets for amounts given to the representative by the beneficiaries of such non-probate assets for the purpose of furnishing funds from which to pay maintenance allowed by the Probate Court.

Inh Tax 159 Selection of Personal Property. M.S. § 297.01 allows as a deduction from the probate estate the value of personal property to the extent of the amount allowed by M.S. § 525.15(1). A similar deduction under subd. 2(4) is allowed where there are no probate proceedings involved. However, the description and value of the assets taken as a selection must be shown on Exhibit V of the Schedule of Non-Probate Assets.

Under M.S. § 525.15(1) and (2), the surviving spouse is allowed the wearing apparel of the decedent and furniture and household goods not exceeding $2,000 in value and other personal property not exceeding $1,000 in value. In addition, if all the personal property of the decedent is allowed to the spouse except one automobile, the surviving spouse shall be entitled to such automobile. If there is no surviving spouse entitled to such selection, but the decedent left minor children, such minor children shall be entitled to property selected on their behalf in accordance with the provisions of M.S. § 525.15(1) and (2).

EXAMPLE: At his death, there was due to decedent $950.00 in unpaid wages. Decedent had no other probate assets. W, widow, may list the unpaid wages as an asset under Exhibit 5 of the Schedule of Non-Probate Assets and claim a deduction of $950.00 for personal property selected by her without being required to secure an order from the Probate Court. (See M.S. § 181.58).

Inh Tax 160 Deduction for Federal Estate Tax.

(a) The federal estate tax is an allowable deduction. The amount to be allowed is the amount claimed on the inheritance tax return filed pursuant to M.S. § 291.09 subject to re-determination within the statutory period established by this section or within ninety days after final determination of the federal tax liability if Form IG-3, **Agreement to Follow Determination and Extend Limitations on Re-Determination or Adjustment of Inheritance Tax** has been executed by the taxpayer and the Commissioner. The deduction will be allowed in full unless subject to apportionment in those cases where installment payments are permitted by the Internal Revenue Service, although the period of payment may extend beyond the date when final determination of the Minnesota inheritance tax liability is made. However, penalties or interest accrued on unpaid federal estate taxes are not allowable.

EXAMPLE: The federal estate tax liability of the estate of X is $100,000. The representative pays $30,000 in 1969 and is granted permission to pay the balance of $70,000 in ten annual installments. On his Minnesota inheritance tax return, the representative is allowed $100,000 as a deduction for federal estate taxes.

(b) M.S. § 291.07(4) prescribed the method for determining the amount of federal estate taxes deductible where the estate consists of both taxable and non-taxable property.

(1) Subject to the specifications provided below, the amount of federal estate tax allowable as a deduction is computed as follows:

(i) The net estate taxable to Minnesota (see (iv)) less transfers to qualified exempt institutions and less the allowable marital deduction, to

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the extent paid out of or attributable to Minnesota property, shall be the numerator of a fraction;

(ii) The denominator of the fraction shall be the value of the net estate everywhere (as defined in (iv) below) less transfers to qualified exempt organizations and less the marital deduction allowed for federal purposes;

(iii) The ratio of the fraction so derived shall be multiplied by the federal estate tax due and payable to the United States Treasury;

(iv) The net estate is defined as the gross value of the estate on the applicable valuation date reduced by any unpaid mortgage on, or any indebtedness in respect of, property where the decedent's interest, undiminished by such mortgage or indebtedness, is included in the value of the gross estate.

EXAMPLE: X, a Minnesota decedent, leaves an estate consisting of a home in Minnesota valued at $50,000, $950,000 in intangible property, and Wisconsin real estate valued at $500,000. The will specifically bequeathes the Wisconsin property to S, a son, and gives the widow ½ of the adjusted federal gross. The balance of the residue goes to S. In addition, a specific bequest of $20,000 is made to the University of Minnesota, and a specific bequest of $5,000 is made to the University of Wisconsin. There are no mortgages or encumbrances against the Minnesota property. There is a $100,000 mortgage on the Wisconsin property. Expenses of administration are $200,000. The numerator is calculated as follows:

Minnesota estate		$1,000,000
*Less marital deduction	$600,000	
Less bequests to Universities of Minnesota and Wisconsin	25,000	
		625,000
Net estate in Minnesota (numerator)		$ 375,000

*As the Wisconsin property has been specifically devised, the marital deduction is allocated on the basis of Minnesota property.

The denominator is calculated as follows:

Gross estate		$1,500,000
Less mortgage on Wisconsin property		100,000
		$1,400,000
Less marital deduction	$600,000	
Less exempt bequests	25,000	
		625,000
Net estate (denominator)		$ 775,000

The federal estate tax allowable as a Minnesota deduction is calculated as follows:

$\frac{375,000 \text{ (numerator)}}{775,000 \text{ (denominator)}} \times \$137,950 \text{ (Federal estate tax)} = \$66,750$

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(2) In those cases where credit for state death taxes, credit for federal gift taxes, credit for taxes on prior transfers or credit for foreign death taxes is allowed (see page 1 of federal form 706), the ratio derived in No. 1 above shall be applied to the federal estate tax liability after giving effect to such credits.

Inh Tax 161 Apportionment of Federal Estate Tax Deduction Between Beneficiaries. Pursuant to M.S. § 525.521 through 525.527, commonly referred to as the Federal Estate Tax Apportionment Act, federal estate taxes are subject to apportionment among the several beneficiaries unless there is a directive to the contrary in the will or in any other controlling instrument. Pursuant to M.S. § 525.521, the burden of the federal estate tax is spread proportionately among the persons interested in a decedent's estate unless the testator has directed otherwise, either by will or by some direction given in a non-testamentary instrument. This section is applicable to both residents and non-residents alike pursuant to other provisions discussed below.

Pursuant to M.S. § 525.522, absent a direction to the contrary, no apportionment shall take place between the persons taking an interest in income, or an estate for years, or a life estate, or any other temporary interest in the property or fund. In such cases, the federal estate tax, in respect of such property or fund, shall be paid out of the corpus or principal of such property or fund before the value of the life estate or other temporary interest is determined for purpose of taxation. The provisions of this section shall be applicable even though the holder of the temporary interest is given rights to the corpus. Unless otherwise provided, a person entitled to an annuity shall not be relieved of the burden of his proportionate share of the federal estate tax (see last sentence of M.S. § 525.522).

M.S. § 525.523 sets out the method of apportionment in the absence of directions to the contrary. Apportionment shall be made in the proportion that the value of the property or interest received by each of the persons benefited bears to the total value of the property received by all persons benefited. The values, as finally determined for federal estate tax purposes, shall be the values to be used as a basis for the apportionment. Exemptions or deductions allowed under federal law by reason of the relationship of any person to the decedent or by reason of the charitable purpose of the gift shall inure to the benefit of the person standing in such relationship or receiving such charitable gift. Any credit for property previously taxed, or credit for federal gift taxes or credit for foreign death taxes shall inure to the benefit of all persons benefited, and the tax to be apportioned shall be the tax after due allowance for such credits. **Although M.S. § 525.523 provides for the apportionment of interest resulting from late payment of the tax, the amount of interest expense so apportioned to each of the beneficiaries is not a deductible expense for inheritance tax purposes.** The provisions of this section relating to discounts allowed for prepayment of the tax are not applicable, as the federal law does not allow a discount for such prepayments.

Pursuant to M.S. § 525.524, any direction as to apportionment or non-apportionment of the tax, whether contained in a will or in a non-testamentary instrument, shall be limited in its operation to the property conveyed by such instrument, unless such will or instrument otherwise directs.

Pursuant to M.S. § 525.525, when the fiduciary (meaning the executor, representative or trustee) who is required to pay the federal estate tax, does

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not hold any property distributable to a beneficiary to whom part of the tax is apportioned, the fiduciary is entitled, and it shall be his duty, to recover from the person benefited or from the person in possession of such property such person's proper share of the tax plus interest or penalty due. However, as noted above, neither interest nor penalties are allowable as a deduction for Minnesota inheritance tax purposes. The Probate Court may, by its order, charge such payment against the share or interest of the person benefited, where assets properly distributable to such person, are in the hands of the fiduciary required to pay the tax. If the amount of the tax cannot be collected, the Probate Court shall determine the manner of charging the amount unrecovered; however, the total amount of federal tax allowable as a deduction will be limited to the amount allowed under M.S. § 291.07.

M.S. § 525.526 provides that the fiduciary may withhold distribution of any property to a beneficiary until the tax apportioned to such beneficiary has been paid. This authority to withhold property extends to a case where the tax apportioned has not yet been determined; however, this section does provide that such property may be released if security adequate to insure ultimate payment is available.

M.S. § 525.527 authorizes the Probate Court to issue the necessary orders apportioning the tax. The authority so granted by this section extends to the apportionment of the tax against a beneficiary taking non-testamentary property. For the purpose of this Regulation, non-testamentary property is deemed to be identical to non-probate assets as defined in M.S. § 291.005, and as described in Inh Tax 112, relating to disclaimer procedures. The following examples are illustrative:

EXAMPLE 1: X, by will, bequeathes his entire residuary estate in trust to pay the income therefrom to S for life with the remainder over to D. The value of the residue, after payment of all expenses of administration, is $200,000. In addition, S is the beneficiary of $100,000 taxable insurance proceeds on X's life. X's will is silent regarding the payment of death taxes. Accordingly, the federal tax will be apportioned in the following manner:

$$\text{(Value received by S)}\ \frac{\$100{,}000}{300{,}000} \times \$59{,}100\ \text{(Federal tax)} =$$

(Total value of all property received by all beneficiaries)

$19,700 apportioned to S

The remaining $39,400 of federal tax is apportioned to the trust. Two points should be noted: (1) The value received by S does not include the value of S's life estate—see M.S. § 525.222; and (2) the total value of the property received by all beneficiaries is based on the amount of the total estate subject to tax but before applying the statutory exemption.

EXAMPLE 2: At X's death, S, his sister, is to receive $12,000 per month for life, and a specific bequest of $10,000. The remainder of the estate, including the remainder value of the trust from which S receives the annuity, is payable to C. Value of the total estate after payment of all expenses of administration is $300,000. The will is silent regarding payment of death taxes. For purposes of this example, the value of the annuity is

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assumed to be $120,000, and the total federal tax is assumed to be $59,100. The federal estate tax will be apportioned as follows:

Annuity value to S	$120,000
Specific bequest to S	10,000
Total value received by S	$130,000

Total value received by all beneficiaries, $300,000.

Value received by S $\frac{\$120,000 + 10,000}{\text{Total value } \$300,000} \times \$59,100 = \$25,610$

Thus, the remaining federal tax of $33,490 is apportioned to the trust.

M.S. § 525.523 specifically requires the beneficiary entitled to an annuity to pay his share of federal taxes unless the will or other controlling instruments states otherwise.

EXAMPLE 3: X, by will, bequeathes his entire residuary estate in trust to pay the income therefrom to S for life with remainder over to D. T, trustee, is authorized to provide additional funds from the trust principal if he deems such expenditures to be necessary in order to provide for the health, welfare and comfort of S. The will is silent regarding payment of death taxes. The entire federal tax will be charged against the trust principal.

EXAMPLE 4: X, by will, bequeathes his entire residuary estate in trust to pay the income for five years to S. At the expiration of the five-year period, the principal is to be divided equally between S, D, E and F. Value of the trust after payment of the expenses of administration is $300,000. The will is silent regarding the payment of death taxes. The entire federal estate tax of $59,100 will be apportioned in accordance with the following computation:

Value of principal after expenses	$300,000.00
Less federal estate tax	59,100.00
	$240,900.00
Less value of S's estate for years 15.8027 × 240,900	38,068.70
	$202,831.30

The tax of $59,100 will be paid by the trustee, although, for purposes of Minnesota inheritance tax, S will be taxed on $88,776.54, with the three remaining beneficiaries being taxed on $50,707.82. It should be noted that S has a vested interest in the remainder, consequently, ¼ of the federal tax will be apportioned to him as under M.S. § 525.522. A holder of a temporary interest is not required to have any part of temporary tax apportioned against him with respect to such temporary interest.

EXAMPLE 5: F, a widower, prior to his death, made a gift of $100,000 to S, his son, and paid a federal gift tax of $6,750. Upon his death, this gift was included in his estate as a gift in contemplation of death. His gross estate was valued at $500,000 (including $100,000 gift in contemplation of death). The federal estate tax, after giving effect to the credit for state death taxes paid, and credit for federal gift taxes paid, was $95,250. The residue of his estate of $350,000 is bequeathed in equal

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shares to S, A, B, and C. The federal tax of $95,250 is apportioned as follows:

S, ¼ of residuary estate	$ 87,500		
Gift included in taxable estate as made in contemplation of death	100,000		tax
	$187,500 / 450,000	× $95,250 =	$39,687.50
A, ¼ of residuary estate	$ 87,500 / 450,000	× $95,250 =	$18,520.83
B, ¼ of residuary estate	$ 87,500 / 450,000	× $95,250 =	$18,520.83
C, ¼ of residuary estate	$ 87,500 / 450,000	× $95,250 =	$18,520.84

EXAMPLE 6: The estate of X, a Minnesota decedent, has a gross value of $1,500,000 all taxable in Minnesota. Homestead valued at $50,000 passes to W, his widow, who is the surviving joint tenant. In addition, W receives, as beneficiary of his life insurance policy, all of X's life insurance proceeds of $500,000 and a specific bequest of $200,000. Balance of the estate goes to S. The adjusted federal gross is $1,300,000, less a marital deduction of $650,000. Taxable estate is $650,000 before the application of the specific exemption. The will is silent regarding payment of death taxes.

Adjusted federal estate		$1,300,000
Less non-probate assets passing to W	$550,000	
Specific bequest to W	200,000	
		750,000
Residue to S		$ 550,000

Federal estate tax is $161,200. The share of federal estate tax apportioned to W is $750,000 less marital deduction of $650,000 or $100,000. The total amount distributable after giving effect to the marital deduction is $650,000. Thus, W's taxable share of $100,000, divided by $650,000, multipled by $161,200 = $24,800, which is apportioned to W. The federal tax apportioned to S is, therefore, $161,200 — $24,800, or $136,400.

EXAMPLE 7: X sets up a revocable trust and provides therein that no death taxes due with respect to the corpus of the trust shall be paid from such corpus. X's will is silent regarding the apportionment of death taxes. The corpus of the revocable trust, valued at $200,000 at X's death, is divided equally between S and D while $300,000 representing the balance of the estate, other than the trust corpus, is divided equally between A, B and C. For the purpose of this example, the federal tax is assumed to be $138,000. This tax will be apportioned as follows:

Value received by A	$100,000 × $138,000 (Federal estate
Value received by all beneficiaries whose interest is subject to apportionment	300,000 **tax**) = $46,000

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The same amount of the federal tax is apportioned to B and C. S and D will not be required to pay any part of the federal estate tax pursuant to the directions against apportionment contained in the revocable trust instrument, in accordance with M.S. § 525.524.

EXAMPLE 8: X, a Minnesota decedent, leaves a net estate of $1,500,000. Part of the estate is represented by Wisconsin real property valued at $500,000. B receives a cash legacy of $200,000 with the balance of the residue divided equally between S and D, respectively. The residue, before payment of death taxes, and the payment of the specific legacy to B, is $1,250,000. The federal estate tax is $351,400. The federal estate tax allowable for Minnesota inheritance tax purposes is $\frac{\$1,000,000}{1,500,000} \times 351,400$ or $234,266.66. The apportionment of federal taxes to B is $\frac{\$\ 200,000}{1,250,000} \times 351,400 = \$56,224$. The apportionment of federal taxes to S is $\frac{\$\ 525,000}{1,250,000}$ (½ of [$1,250,000 — 200,000] × 351,400 = 147,588). Same amount to D. B is allowed a deduction of the full amount of the federal estate tax apportioned to him as the property passing to him is entirely taxable by Minnesota. However, as S and D share equally in the Wisconsin property, each is allowed as a deduction in respect of the Minnesota property calculated as follows: Federal tax allowable for Minnesota: $234,266.66 — 56,224 (deduction allowed to B) = $178,042.66. One-half thereof allowable to S, $89,021.33 and one-half allowable to B, $89,021.33. However, it should be noted that S and B each will be required to pay federal estate taxes of $147,588.

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CHAPTER SIXTEEN: INH TAX 171-185

EXEMPTIONS

Inh Tax 171 In General. M.S. § 291.05 provides for certain exemptions from inheritance taxes. M.S. § 291.03 sets out the manner in which the tax shall be computed so as to give effect to the exemptions allowed under Clauses 3 through 7 of M.S. § 291.05.

Inh Tax 172

(a) Gifts for public, religious, charitable, scientific, literary, educational or public cemetery purposes.

(1) A transfer that would otherwise be taxable under the provisions of Chapter 291 shall be exempt if made to an organization described in Clause 1 of M.S. § 291.05, for one of the purposes enumerated therein, if the laws of the state under the laws of which such transferee was organized or exists, either

(aa) does not impose a death tax of any character on property transferred to a similar transferee which was organized or exists under the laws of Minnesota, or

(bb) contains a reciprocal provision under which similar transferees organized or existing under the laws of Minnesota are exempt from death taxes in such other state.

EXAMPLE 1: Decedent, a Minnesota resident, bequeaths $10,000 to a church located in North Dakota. North Dakota's inheritance tax law exempts from taxation any bequest, legacy, devise, or transfer made to a church. Therefore, the $10,000 bequest to the North Dakota church will be exempt from Minnesota inheritance taxes.

EXAMPLE 2: Decedent Y, a Minnesota resident, bequeaths $15,000 to a church located in Wisconsin. Wisconsin's inheritance tax law grants an exemption to a church in any other state if such state grants equal exemption to a bequest, legacy, devise, or transfer made to Wisconsin churches. Therefore, the $15,000 bequest to the Wisconsin church will be exempt from Minnesota inheritance taxes.

(2) A transfer to a clergyman that would otherwise be taxable will be exempt to the extent of $1,000 if the proceeds are to be used for religious purposes or rites designated by the testator.

EXAMPLE 3: T, a testator, bequeaths $2,000 to Father Smith, who is not a blood relation, with the proviso that the latter will use the proceeds for the purpose of saying masses for T. The first $1,000 of this bequest will be exempt. Father Smith will be taxed on the balance, after giving effect to the $500 exemption allowed a stranger.

(b) The following are exempt under Clause 2 of M.S. § 291.05:

(1) The homestead of a decedent and the proceeds thereof if such property was sold during administration, passing to the spouse or to any minor or dependent child of the decedent, whether natural or adopted, limited to $30,000 or to the value of such property whichever is the lesser.

The value of the property shall be the fair market value at date of valuation less any encumbrances against the property existing on such date.

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(2) Proceeds of any insurance policy issued by the United States and generally known as war risk insurance, United States government life insurance or national service life insurance.

(3) Proceeds of payments from the United States Railroad Retirement Fund.

(4) Proceeds of payments from the United States Social Security benefits.

For the method of computing the tax with respect to exemptions allowed under Clause 2 see example 1 under Inh Tax 75.

(c) The statutory exemptions are set forth in Clauses 3 through 7 of M.S. § 291.05. For the method of computing the tax so as to give effect to these exemptions see examples under Inh Tax 76.

Inh Tax 173 M.S. § 291.06 provides for the exemption from inheritance taxes for property which can be identified as having been transferred to the decedent by a person who had died within a period five years prior to the death of the decedent. The exemption so allowed shall be subject to the following conditions and limitations:

(a) Relationship of the parties. The relationship of the transferee or beneficiary to the decedent must be that of spouse, child or other lineal descendent, legally adopted child or issue, lineal ancestor, or mutually acknowledged child or lineal issue, as defined under M.S. § 291.03(1) and (2). The relationship of the decedent to the person from whom such property had been transferred must also have been that of spouse, child or other lineal descendent, legally adopted child or issue, lineal ancestor, or mutually acknowledged child or lineal issue, as defined under M.S. § 291.03(1) and (2).

(b) Time limitation. The person from whom the decedent had received the property must have died less than five years before the death of the decedent. The time at which the property was actually transferred to or received by the decedent is irrelevant.

(c) Extent of the exemption. An inheritance tax must have been determined and actually paid to this state on the transfer of the property from the first decedent to the second decedent. Mere filing of an inheritance tax return is not sufficient to qualify for the exemption. This exemption shall be limited to the value of property which was in excess of the amount of the exemption allowed on the transfer to the second decedent.

EXAMPLE: H left his entire estate to W, his wife. The estate was valued at $100,000, and an inheritance tax was paid to the state of Minnesota on $70,000 ($100,000 less the widow's exemption of $30,000). Before the estate is distributed, W dies and leaves the $100,000 to S, her son. S may claim an exemption of $70,000 under this section.

No reduction of this exemption shall be made because of other exemptions or deductions claimed by the transferee, except that the total exemptions for a single item of property shall not exceed its value.

(d) Identification of the property. The exempt property must be identified as property received by the second decedent from the first decedent. This exemption is not limited to property identified as the specific or identical property received from the first decedent but extends to substituted

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property acquired by the process of exchange, including the proceeds of the sale or other disposition of property so received as well as property acquired with such proceeds. The number of exchanges is immaterial. Such substituted property, however, must be property identified as acquired through exchange of the specific property received from the first decedent and must be clearly traced to the specific property originally so received.

When the property received from the first decedent or the proceeds therefrom were comingled with the second decedent's property or funds from other sources, a proportionate part of the lowest value of the comingled property or funds between the date of comingling and decedent's death shall be exempted under this section. If other property was acquired through withdrawals from comingled funds and claimed as exempt property, such other property shall be presumed to have been acquired with property received from the prior decedent or the proceeds therefrom if the balance of the comingled fund remained above the purchase price of such other property at all times prior to its purchase. If such other property is not claimed as exempt property or if property is not acquired with the withdrawals, however, it shall be presumed that the property received from the first decedent or the proceeds therefrom were the last part of the comingled fund to be spent.

EXAMPLE: H left $30,000 in cash to S, his son, who paid an inheritance tax on all of it. S deposited $20,000 in a bank account containing $20,000 of his own money and invested $10,000 in his own private business, in which he had already invested $50,000. One year later he withdrew $10,000 from the bank account to buy 100 shares of XYZ stock. S dies the next year and leaves to W, his wife, his business, the 100 shares of XYZ stock, and the bank account with $15,000 in it. S began using the money in the bank account for his personal living expenses after he bought the XYZ stock, but the balance never fell below $8,000. The stock never was worth less than $10,000 and is now worth $12,000. The capital account of the business once fell to $30,000 but is now at $75,000. W may exempt: (1) $8,000 from the bank account, since it is presumed that S's personal expenses were first made from deposits other than the previously taxed property; (2) $10,000 worth of stock, since it is presumed that the previously taxed property was used to purchase it; (3) a $6,000 share in the business, since this is the proportionate share of its lowest value between the investment and S's death that is attributable to the previously taxed property.

The exempt property shall be presumed to pass with the residue of the second decedent's estate, regardless of which transferee actually receives such property, unless the contrary clearly appears (the contrary would clearly appear, for example, from a specific bequest or devise of such property). If the residue is divided among several transferees, or if the estate passes to several transferees by intestate succession, such transferees shall be presumed to receive a proportionate part of the exempt property. The exempt property shall be considered the last part of the residue or intestate estate to be expended for general claims against the estate or administrative expenses.

(e) Amount exempt. This exemption is limited to the value of the property at the date of death of the prior decedent or the value of the property (or property traceable to it) at the date of death of the present decedent, whichever is lower. Each individual item of property is considered separately at its lower value.

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The value of previously taxed property, to the extent that it is exempt under this section, shall not be included in determining the rate applicable under M.S. § 291.03 to other transfers made to the transferee.

The burden is on the exemption claimant to bring himself within this exemption.

Inh Tax 174 In General. M.S. § 291.065 exempts from inheritance taxation the value of an annuity or other payment receivable by a survivor — beneficiary under certain "qualified plans" and under certain annuity contracts to the extent provided in Inh Tax 84 of this section. This section applies to all payments receivable by any survivor — beneficiary after December 31, 1956.

Inh Tax 175 Plans to which M.S. § 291.065 applies. M.S. § 291.065 exempts from inheritance taxation, to the extent provided in Inh Tax 84 of this section, the value of an annuity or other payment receivable by any survivor-beneficiary (except the value of an annuity or other payment receivable by or for the benefit of the decedent's estate) under:

(a) An employee's trust (or under a contract purchased by an employee's trust) forming part of a pension, stock bonus, or profit-sharing plan, which at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of the termination of the plan, if earlier, met the requirements of section 401(a) of the Internal Revenue Code of 1954, as adapted to the provisions of this chapter under these regulations, or,

(b) A retirement annuity contract purchased by an employer (and not by an employee's trust) pursuant to a plan, which at the time of the decedent's separation from employment (by death or otherwise), or at the time of termination of the plan, if earlier, met the requirements of paragraph (3) of section 401(a) of the Internal Revenue Code of 1954, as adapted to the provisions of this chapter under these regulations.

(c) For the purposes of this section the term "annuity or other payment" as used with respect to both the decedent and the beneficiary has reference to one or more payments extending over any period of time. The payments may be equal or unequal, conditional or unconditional, periodic or sporadic.

(d) For the purposes of this section, the fact that a death benefit constitutes the proceeds of life insurance shall be considered immaterial.

EXAMPLE 1: Pursuant to a pension plan, the employer made contributions to a trust which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his wife, upon the employee's death after retirement, with a similar annuity for life. At the time of the employee's retirement, the pension trust formed part of a plan meeting the requirements of section 401(a) of the Internal Revenue Code of 1954. Assume that the employee died at the age of sixty-one after the trustee started the payment of his annuity as described above. Since the wife's annuity was receivable under a qualified pension plan, no part of the value of such annuity is subject to inheritance taxation.

EXAMPLE 2: Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee's individual account. Under the plan, the employee would, upon his retirement at age sixty, receive a distribution of the entire amount credited to his account. If he should die before reaching the retirement age, the amount credited to

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his account would be distributed to his designated beneficiary. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of section 401(a) of the Internal Revenue Code of 1954. Since the designated beneficiary's lump sum payment was receivable under a qualified profit-sharing plan, no part of such lump sum payment is subject to inheritance taxation.

EXAMPLE 3: Pursuant to a pension plan, the employer made contributions to a trust which were used by the trustee to purchase a contract from an insurance company for the benefit of an employee. The contract was to provide the employee upon his retirement at age 65, with an annuity of $100 per month for life, and was to provide his designated beneficiary, upon the employee's death after retirement, with a similar annuity for life. The contract further provided that if the employee should die before reaching the retirement age, a lump sum payment equal to the greater of (a) $10,000 or (b) the reserve value of the policy would be paid to his designated beneficiary in lieu of the annuity described above. Assume that the employee died before reaching the retirement age and that at such time the plan met the requirements of Section 401(a) of the Internal Revenue Code of 1954. Since the designated beneficiary's lump sum payment was receivable under a qualified pension plan, no part of such lump sum payment is subject to inheritance taxation.

EXAMPLE 4: Pursuant to a profit-sharing plan, the employer made contributions to a trust which were allocated to the employee's individual account. Under the plan, the employee would, upon his retirement at age 60, be given the option to have the amount credited to his account (a) paid to him in a lump sum, (b) used to purchase a joint and survivor annuity for him and his designated beneficiary, or (c) left with the trustee under an arrangement whereby interest would be paid to him for his lifetime with the principal to be paid, at his death, to his designated beneficiary. The plan further provided that, if the third method of settlement is selected, the employee will retain the **right to have the principal paid to himself in a lump sum up to the time of his death.** At the time of the employee's retirement, the profit-sharing plan met the requirements of section 401(a) of the Internal Revenue Code of 1954. Assume that the employee, upon reaching the retirement age, elected to have the amount credited to his account left with the trustee under the interest arrangement. Assume also that the employee did not exercise his right to have such amount paid to him before his death. Under these circumstances, the employee is considered as having constructively received the amount credited to his account upon his retirement. Thus, such an amount is not considered as receivable by the designated beneficiary under the profit-sharing plan and the exemption under this section is inapplicable.

Inh Tax 176 Amount exempt from inheritance taxation under this section.

(a) The amount to be exempt from inheritance taxation under M.S. § 291.065 is an amount which bears the same ratio to the value at decedent's death of the annuity or other payment receivable by the survivor-beneficiary as the employer's contribution (or a contribution made on his behalf) on the employee's account to the plan or towards the purchase of the annuity contract bears to the total contributions on the employee's account to the plan or towards the purchase of the annuity contract. In applying this ratio, the value at the decedent's death (on or after April 10, 1961), of the annuity or other payment shall be determined by the rule, method, and standards of mortality and value employed for federal estate tax purposes under

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the Internal Revenue Code of 1954, as amended. For deaths occurring before April 10, 1961, the value at the decedent's death of the annuity or other payment shall be determined by the rule, method, and standard of mortality and value employed by the commissioner of insurance in ascertaining the value of policies of life insurance and annuities for the determination of liabilities of insurance companies, provided that the rate of interest and discount rate, for making such computation, shall be four percent per annum.

(b) Where the employer's contributions to a plan on the employee's account and thus the total contributions to the plan on the employee's account cannot be ascertained readily, the method outlined in the following two sentences must be used unless a more precise method is presented. In such a case, the total contributions to the plan on the employee's account is the value of any annuity or other payment payable to the decedent and his survivor computed as of the time the decedent's rights first mature (or as of the time the survivor's rights first mature) (or as of the time the survivor's rights first mature if the decedent's rights never mature) and computed in accordance with the rules set forth in subparagraph (a) of this regulation. By subtracting from such value the amount of the employee's contribution to the plan, the amount of the employer's contribution to the plan on the employee's account may be ascertained.

EXAMPLE: Pursuant to a pension plan, the employer and the employee contributed to a trust which was to provide the employee, upon his retirement at age 60, with an annuity for life, and which was to provide his wife, upon the employee's death after retirement, with a similar annuity for life. At the time of the employee's retirement, the pension trust formed part of a plan meeting the requirements of section 401(a) of the Internal Revenue Code of 1954. Assume the following: a) that the value of the employee's annuity and his wife's annuity, as of the time of his retirement was $40,000; b) that the employer's contribution to the fund was not credited to the account of the individual employees; c) that the employee contributed $10,000 to the plan; and d) that the value at the decedent's death of the wife's annuity was $16,000. Thus the total contributions to the fund on the employee's account are presumed to be $40,000 and the employer's contribution to the plan on the employee's account is presumed to be $30,000 ($40,000 less $10,000). Since the wife's annuity was receivable under a qualified plan, that part of the annuity which is attributable to the employer's contributions ($30,000 × $16,000, or $12,000) is exempt from inheritance taxation.

(c) Any payments receivable by a survivor-beneficiary pursuant to pension and annuity plans provided for members of the Public Employees Retirement Association, the State Employees Retirement Association, and the State Teachers Retirement Association are exempt from inheritance taxation. However, payments receivable by a survivor-beneficiary under pension and annuity plans provided for state and public employees not members of the above groups are subject to the provisions of M.S. § 291.065.

Inh Tax 177 Pension and annuity plans under the United States Civil Service Retirement System qualify under section 401(a) of the Internal Revenue Code of 1954. Payments receivable by a survivor-beneficiary under such a plan are entitled to the exemption provided by M.S. § 291.065.

Inh Tax 178 If the plans in effect for State and Public Employees, who are not members of the associations listed in (d) above, meet the requirements

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of section 401(a) of the Internal Revenue Code of 1954, they will be subject to the provisions of M.S. § 291.065. The Commissioner of Taxation will determine whether or not such requirements are met.

Inh Tax 179 In the case of a decedent dying after June 30, 1963, a retirement annuity contract purchased for an employee by an employer which, for its taxable year in which the purchase occurred, is an organization referred to in section 503 (b) (1), (2), or (3), and is exempt from tax under section 501(a), is subject to the provisions of this regulation.

EXAMPLE: An employer purchased a retirement annuity contract for an employee which was to provide the employee, upon his retirement at age 60, with an annuity for life and which was to provide his wife, upon the employee's death after retirement, with a similar annuity for life. The employer, for its taxable year in which the annuity contract was purchased, was an organization referred to in section 503 (b) (1), (2), or (3), and was exempt from tax under section 501(a). The entire amount of the purchase price of the annuity contract was excluded from the employee's gross income under section 403(b). No part of the value of the survivor annuity payable after the employee's death is includible in the decedent's gross estate by reason of the provisions of M.S. § 291.065.

Inh Tax 180 Additional Exemption in Lieu of Maintenance.

(a) Where decedent died on or after July 1, 1965, an additional exemption, represented by the difference between the maximum amount of maintenance allowed to the widow as a deduction, pursuant to M.S. § 291.10 (presently $5,000), and the amount allowed by the Probate Court, is allowable. If no probate proceedings are had, the widow shall be allowed an additional exemption represented by the maximum allowable under M.S. § 291.10.

(b) In the event that the decedent left no widow entitled to the additional exemption allowed under clause (a), the additional exemption will be allowable to minor or dependent children of the decedent, whether they be natural or adopted. Where there are minor children, the aggregate amount of the exemption allowable therewith shall not exceed the limitation on such additional exemption applicable to a widow under clause (a) above.

(c) The provisions granting the additional exemptions described above were added to M.S. § 291.05(3) and (4), which relate to the statutory exemption allowed to widows and minor children, respectively. As these statutory exemptions (presently $30,000 to a widow and $15,000 to a minor child) are allowable against the money value taxed in the lowest bracket, the exemptions allowed in lieu of maintenance will also be allowed against the money value of the lowest bracket. The exemption is limited to a wife or to minor or dependent children, consequently, it is not allowable where the surviving spouse is the husband.

(d) The following examples are illustrative:

EXAMPLE 1: The Probate Court allowed $5,000 maintenance to W, widow;

Maximum amount allowable	$5,000
Amount allowed by Probate Court	5,000
Additional exemption allowed	–0–

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EXAMPLE 2: The Probate Court allowed as maintenance, $3,000 to W, widow;

Maximum amount allowable	$5,000
Amount allowed by Probate Court	3,000
Amount subject to additional exemption	$2,000

The first bracket, which has a maximum of $25,000, absorbs $25,000 of the $30,000 statutory exemption. The second bracket absorbs the remaining $5,000, **and the $2,000 allowed as an additional exemption herein.** Consequently, the additional exemption allowed is $40.00 ($2,000 × 2%).

EXAMPLE 3: H's estate consists of non-probate assets only; consequently, no probate is required. W, widow, receives assets of $150,000 after giving effect to all deductions allowable. The calculation is as follows:

Tax on $150,000 to a widow (see Inh Tax 207 or Table on last page of Form IG-1)	$3,900
Less additional exemption allowed when no probate proceedings are involved ($5,000 × 2% = $100)	100
Tax due	$3,800

Form IG-1 provides a handy method for calculating this additional exemption. See page 2 for computation to be used for surviving wife. Under A, it will be noted that a blank is provided for the tentative tax which, in this case, is $3,900. The form then provides the maximum allowable, $5,000, less the amount allowed by Probate Court which is –0–. The remaining exemption of $5,000 in B (see B) is multiplied by 2% which equals $100. Consequently, the tax is $3,800.

EXAMPLE 4: H's probate estate is valued at $2,000. The Probate Court, in summary proceedings under M.S. § 525.51, distributes the entire probate estate to W pursuant to M.S. § 525.15. In addition, W takes non-probate assets of $35,000. Tentative tax on $35,000 to a widow is $100.

Maximum allowed	$5,000
Amount allowed by Probate Court	–0–
Amount subject to additional exemption	$5,000
Additional exemption ($5,000 × 2%)	100
Tax due	$ –0–

It should be noted that the $2,000 distributed to W by the Probate Court is an allowable deduction under M.S. § 291.07, subd. 1(6).

EXAMPLE 5: F, a widower, established a revocable trust, reserving for himself the income with remainder over at his death to be paid to S, D-1 and D-2, his children aged 25, 20 and 18, respectively. All expenses, including legal fees, fiduciary fees and death taxes are to be paid from the trust principal which is to be distributed when his youngest child attained the age of 21. The value of the estate subject to tax is $180,000. The taxes are computed as follows:

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Tax on $60,000 to S (adult child)		$1,980.00
Tentative tax on $60,000 to D-1, minor child	$950.00	
Less ½ of additional amount subject to exemption, $2,500		
Tax on $2,500 at 1½%	37.50	
Tax due from D-1		912.50
Same formula to be used for D-2		912.50
Total tax		$3,805.00

It should be noted that the $15,000 exemption allowed to a minor does not exceed the entire statutory exemption of $25,000 allowed in the first bracket, consequently, the additional exemption is allowable at 1½%.

EXAMPLE 6: An insurance policy on F's life pays $16,000 to S, and $32,000 to D, both minor children of F. The proceeds are taxable. All other expenses were paid from a bank account held jointly in the names of F and his brother, B. The tax due from S and D is calculated as follows:

Tentative Tax on $16,000 payable to S	$ 15.00
Exemption allowed ($1,000 × 1½%)	15.00
Tax due from S	–0–
Tentative tax on $32,000 payable to D	$290.00
Exemption allowed ($4,000 × 1½%)	60.00
Tax due from D	$230.00

In this example, the additional credit allowed to D is the full amount of the exemption credit $75.00, less the $15.00 allocated to S or $60.00. The law does not require that the $5,000 maximum exemption allowed be allocated equally between the beneficiaries entitled thereto.

Inh Tax 181 Children, Minor, Dependent or Mutually Acknowledged.

M.S. § 291.03, provides the rates and exemptions applicable to the various classes of beneficiaries. No difficulty should be experienced in determining the applicable relationship between the decedent and a beneficiary listed in this section of the law, with the following exceptions:

Clause 1 of this section of the law reads as follows:

> "Where the person entitled to any beneficial interest in such property shall be the widow, minor or dependent child of the decedent, or any minor or dependent legally adopted child at the following prescribed rates."

For purposes of this Regulation, a minor child is one who has not attained the age of 21 years at the date of death of the decedent.

The rates and exemptions for a dependent child of the decedent or a dependent legally adopted child of the decedent will be allowed or disallowed after the Commissioner has considered all the facts involved. If the determination is made by the Probate Court, the Commissioner will appeal therefrom where he does not agree with the Court's findings.

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Clause 2 of this section reads in part as follows:

> ". . . or any child to whom such decedent for not less than ten years prior to such transfer stood in the mutually acknowledged relation of a parent, provided, such relationship began at or before the child's fifteenth birthday and was continuous for said ten years thereafter, or any lineal issue of such mutually acknowledged child, at the following prescribed rates:"

Before the relationship of the mutually acknowledged child is given recognition for inheritance tax purposes, the provision quoted above will be strictly construed.

Where there are probate proceedings, the evidence necessary to sustain this relationship should be presented to the Probate Court.

Where the necessary evidence to sustain the status of the mutually acknowledged child has not been presented to the Probate Court, or where there are no probate proceedings involved, the Commissioner of Taxation may request that evidence be presented to him or that the necessary witnesses appear before him at his office and testify under oath as to the facts involved.

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CHAPTER SEVENTEEN: INH TAX 186-190

MINNESOTA ESTATE TAX

Inh Tax 186 Imposition of Tax. Pursuant to M.S. § 291.34, an estate tax is imposed upon the estate of a decedent who was a resident of Minnesota at death.

> "The amount of tax so assessed shall be the amount by which the maximum credit which the federal government will allow as a credit for state death taxes under the federal estate tax law shall exceed the aggregate amount of all estate, inheritance, legacy, and succession taxes actually paid to the United States in respect of any property owned by such decedent, or subject to such taxes as a part of or in connection with his estate."

The amount of death taxes actually paid is the tax assessed before giving effect to the credit allowable with respect to gift taxes paid on property required to be included in the inheritance tax return of the decedent. (See M.S. § 292.14 and Inh Tax 137) Interest accrued and paid on inheritance tax (See M.S. § 291.15), or penalties and accrued interest required to be paid on delinquent gift taxes, whether paid to Minnesota or to a sister state, shall not be included in the calculation of Minnesota estate tax. Any death taxes paid to a foreign country or to any possession of the United States shall not be included in the calculation of the Minnesota estate tax (See Internal Revenue Code, Section 2014 (g)).

The following examples are illustrative:

EXAMPLE 1: The federal estate tax liability for the estate of X, a Minnesota decedent, before giving effect to the credit for state death taxes actually paid, was $1,263,200. The credit for state death taxes allowed reduced the federal estate tax liability by $187,280. The Minnesota inheritance tax assessed was $185,000. Accrued interest paid, with respect to the Minnesota inheritance tax liability was $10,000. There were no death taxes paid to other states. The Minnesota estate tax is calculated as follows:

Federal credit for state death taxes allowed	$187,280.00
Minnesota inheritance tax assessed and paid	185,000.00
Minnesota estate tax	$ 2,280.00

EXAMPLE 2: Same facts as example 1 above. However, the representative of X's estate failed to pay the Minnesota estate tax of $2,280.00 within the four-year period beginning with X's death. (See Internal Revenue Code, Section 2011(c)). As a consequence, the Internal Revenue Service allowed, as a credit, $185,000, representing the amount previously paid to Minnesota. The Minnesota Commissioner of Taxation will assess a Minnesota estate tax of $2,280 in accordance with a calculation similar to the one used in example 1 above. Picking up the credit, even though the federal government fails to allow it because of expiration of the statutory four-year period, is in accordance with M.S. § 291.341, which refers to "the maximum credit which the federal government will allow."

EXAMPLE 3: The federal estate tax liability, with respect to the estate of X, a Minnesota decedent before the application of the credit for state death taxes, was $1,263,200. The credit allowed reduced the federal estate

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tax liability by $187,280. The Minnesota inheritance tax assessed was $185,000 which was reduced to $140,000 by a credit for gift taxes paid. (See Inh Tax 137) The Minnesota estate tax computation is as follows:

Federal credit for state death taxes allowed	$187,280.00
Less Minnesota inheritance tax assessed and paid	185,000.00
Minnesota estate tax	$ 2,280.00

EXAMPLE 4: The federal estate tax liability with respect to the estate of D, a Minnesota resident at his death, before application of the federal credit for state death tax is paid, was $2,468,200. The state death tax credit was $398,320. Included in the federal estate subject to tax was real property located in Florida with respect to which the representative paid $150,000 of death taxes. This latter amount was the Florida "pick-up tax" based upon the value of the Florida property. The Minnesota inheritance tax paid was $230,000. The Minnesota estate tax computation is as follows:

Federal credit for state death taxes allowed		$398,320.00
Less death taxes paid to states		
Minnesota	$230,000.00	
Florida	150,000.00	
		380,000.00
Minnesota estate tax		$ 18,320.00

Inh Tax 187 Time for Payment. The time of payment of the Minnesota estate tax is prescribed by M.S. § 291.35 which reads as follows:

> "The tax imposed by sections 291.34 to 291.40 shall become due and payable at the expiration of 18 months after the death of the person from whom the transfer is made, and executors, administrators, trustees, grantees, donees, beneficiaries, and surviving joint owners shall be and remain liable for the tax until it is paid. If the tax is not paid when due, interest at the rate of six percent per annum shall be charged and collected from the time the same became payable."

In order to avoid the accrual of interest, the taxpayer may estimate the amount of Minnesota estate tax that will be due and owing and pay this amount. (See M.S. § 291.15).

EXAMPLE: The taxable estate of X, a Minnesota decedent, was $3,000,000. The federal estate tax liability was $1,263,200. See Table A on last page of Federal Estate Tax Form. By referring to Table B, also located on the last page of Form 706, the representative ascertains that the maximum credit for state death taxes, with respect to this estate, is $187,280. This, in effect, is the minimum amount of Minnesota death taxes that the estate will be liable for. If the representative then determines that the Minnesota inheritance taxes due will be less than this minimum amount, he may avoid the accrual of interest, and at the same time, protect the federal credit by prepaying the minimum amount, namely $187,280 within 18 months after death.

Inh Tax 188 Apportionment of Tax. Effective July 1, 1965, M.S. § 291.40 was amended so as to apportion the Minnesota estate tax among

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beneficiaries in accordance with M.S. §§ 525.521 through 525.527. The law, as amended, requires that the maximum credit shall be apportioned in accordance with the provisions of M.S. §§ 525.521 through 525.524, and that there shall be deducted therefrom the aggregate death taxes required to be paid by or on behalf of the several beneficiaries. The following example is illustrative:

EXAMPLE: X's gross estate was valued at $3,000,000 at date of death. His will devised Blackacre, valued at $1,500,000, in equal shares to his four sons. The residue is bequeathed to his three daughters. The alternate method is elected, and Blackacre is valued at $1,300,000, while the property comprising the residue is valued at $1,200,000. The adjusted gross estate is $2,200,000. The will is silent about the payment of death taxes, and as a consequence, the federal estate tax must be apportioned among the beneficiaries.

Federal estate tax	$ 851,200.00
Less credit for state death taxes paid	119,600.00
Net amount payable	$ 731,600.00
Computation of residue:	
Net probate estate	$2,200,000.00
Less specifics	1,300,000.00
Residue	$ 900,000.00

Computation of federal tax required to be paid by each beneficiary:

Each daughter receives $300,000.00 (⅓ of $900,000.00)

$300,000 = 13.636%
2,200,000

This ratio (13.636) multiplied by $731,600 (federal tax payable) = $99,760.98

Each son receives $325,000 (¼ of $1,300,000.00) $325,000 = 14.773%
2,200,000

This ratio (14.773) multiplied by $731,600 (federal tax payable) = $108,079.27.

Computation of inheritance tax
Each daughter:

Amount received from estate		$300,000.00
Less share of federal estate tax		99,760.98
Amount subject to tax		$200,239.02
Tax to an adult daughter	$11,399.12	

Inheritance tax for each son:

Amount received from estate	$325,000.00
Less share of federal estate tax	108,079.27
Amount subject to tax	$216,920.73

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Tax to each adult son	$12,733.66	
Computation of Minnesota estate tax due		
Federal credit for state death taxes allowed		$119,600.00
Death taxes paid		85,132.00
Minnesota estate tax		$ 34,468.00
Computation of individual Minnesota estate tax		
Each daughter's share of credit for state death taxes—		
13.636% × $119,600 =		$ 16,308.66
Less Minnesota inheritance taxes paid		11,399.12
Minnesota estate tax due from each daughter		$ 4,909.54
Each son's share of credit for state death taxes—		
14.773% × $119,600 =		$ 17,668.51
Less Minnesota inheritance taxes paid		12,733.66
Minnesota estate tax due from each son		$ 4,934.85
Total of Minnesota estate tax due from the beneficiaries:		
$4,909.54 × 3 =		*$ 14,728.60
$4,934.85 × 4 =		19,739.40
Total		$ 34,468.00

*Adjustment for fractional pennies.

SUMMARY

The procedures involved in the foregoing calculations are as follows:

Step 1: The federal estate tax less the credit is computed first.

Step 2: The value of the share required to be distributed to each of the beneficiaries is computed.

Step 3: The amount required to be distributed to each beneficiary is divided by the total amount required to be distributed to all beneficiaries.

Step 4: The ratio derived in Step 3 is multiplied by the amount of federal estate tax after deducting therefrom the amount of the credit for state death taxes allowable.

Step 5: The Minnesota inheritance tax is computed by subtracting from the amount received by each beneficiary the proportionate amount of federal estate tax required to be paid by such beneficiary in accordance with Step 4 above.

Step 6: The total amount of Minnesota estate tax is computed by subtracting from the federal credit for state death taxes allowed, the total death taxes paid to all states by or on behalf of all the beneficiaries.

Step 7: The ratio derived in Step 3 is multiplied by the maximum amount of credit allowable by the federal. From the amount so derived, the death tax paid on behalf of the beneficiary is subtracted. The balance represents the Minnesota estate tax payable by such beneficiary.

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CHAPTER EIGHTEEN: INH TAX 190-205

GENERAL REQUIREMENT OF RETURN, SCHEDULE OR LIST

Inh Tax 190 Every person made liable for a tax imposed by Chapter 291 shall make such return, schedule or list as required by these regulations. The return, schedule or list shall include therein the information required by the applicable regulations or forms. Effective January 1, 1964.

Inh Tax 191 Probate Proceedings.

(a) Schedule of Non-Probate Assets. Every executor, administrator or representative of the estate of a deceased person shall file with the Probate Court on Form IG-2 a true and complete schedule of all non-probate assets of the decedent. This Form IG-2 is to be filed with the court at the same time that the verified inventory and appraisal of the probate assets of the decedent are filed with the court. A copy of Form IG-2 shall be forwarded to the Commissioner of Taxation, Inheritance Tax Division, at the time that the same is filed with the court.

(b) Inheritance Tax Return. Every executor, administrator or representative of the estate of a deceased person shall file with the Commissioner of Taxation on Form IG-1, an Inheritance tax return. The values contained in the inventory and appraisal shall be reflected in this return as well as the value of all non-probate assets. In addition, all deductions and exemptions provided for by Chapter 291 shall be enumerated as they are claimed by a representative and there shall be a computation of the Inheritance tax due. A copy of such return shall be filed with the Probate Court.

In listing and describing any non-probate asset, adequate identifying information shall be furnished. For example, listing of money in a bank account should disclose the name and address of the depository, whether checking, savings, or time deposit savings account, return of interest, and serial number; a description of life insurance should list the name of the insurer, number of the policy, name of the beneficiary and amount of proceeds.

(c) Objections to Inheritance Tax Return. The Statute provides in M.S. § 291.09, Subdivision 1 (c) that the values shown upon the Inheritance tax return as to both probate and non-probate assets shall be conclusive unless objection is made to said values within 90 days after the filing of the Inheritance tax return with the Commissioner of Taxation. The Statute further provides that the return shall be conclusive as to all other matters relating to the taxability of probate assets unless written objection is filed within 90 days as set forth above.

Objections as to the value of any assets shown on the Inheritance tax return or relating to any other matter of taxability of probate assets must be filed in writing with the Probate Court. Such objection may be filed by the Commissioner, the representative of the estate or any other person from whom any portion of tax shown to be due on the return is or may be due.

Pursuant to the filing of such written objections, the Probate Court is by the Statute directed to schedule hearing upon such objections giving 30 days mailed notice to the interested parties. After such hearing, the court shall make its order determining the matter objected to, and the Inheritance tax return shall be adjusted by the Commissioner in conformance with the order of the Probate Court.

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(d) Representative's Account — Decree of Distribution. If the Probate Court approves an account of a representative, which account allows a deduction in amount different than was used in the determination of the tax on the Inheritance tax return, or if the decree of distribution assigns property to persons other than those reflected in the Inheritance tax return or assigns property in different shares than the shares shown on the Inheritance tax return, the Commissioner shall issue his order adjusting the computation of the Inheritance taxes due in accordance with the settled account or decree. In addition, if the Probate Court finds that the relationship between the decedent and any person who takes property under the decree of the court is different than that reflected on the Inheritance tax return, the Commissioner shall recompute the Inheritance taxes due in accordance with said determination of the Probate Court.

The action of the Commissioner in adjusting computation of the Inheritance taxes due in accordance with the settled account or decree of distribution must be consumated no later than 90 days after the receipt of the court's order or decree.

Inh Tax 192 Non-Probate Assets.

(a) Procedure Where No Probate Proceedings Are Instituted. In cases where there are no Probate Court proceedings relative to the estate of a deceased person, but certain property, interests in property, or rights are transferred, assigned, or pass to certain individuals under such circumstances that Inheritance tax is due, M.S. § 291.09, Subd. 2.

2(a) requires that every such person subject to a tax under the provisions of M.S. Chapter 291 file with the Commissioner on Form IG-2 a schedule of non-probate assets and also an Inheritance tax return Form IG-1 upon which return all assets shall be listed and deductions and exemptions claimed and the tax due computed.

(b) Objections to Inheritance Tax Returns. In cases where no probate proceedings have been instituted, and in consequence thereof, the Inheritance tax return filed will list only non-probate assets, objections to valuation or any matter relating to the taxability of non-probate assets shall be determined by the Commissioner of Taxation. Objections to the Inheritance tax return as filed in such cases must be made within 90 days after the filing of the return with the Commissioner. Any person from whom any portion of taxes imposed by Chapter 291 is or may be due, may under M.S. § 291.09, Subdivision 2 (b) file such objection with the Commissioner of Taxation. The person making such objection shall mail written notice thereof to the Commissioner, to the person filing the return and to each person from whom any part of such tax is or may be due. Such written notice shall identify the property involved and shall clearly state the basis upon which the objection is made. The Commissioner of Taxation shall set the time and place of the hearing which shall be at least 30 days subsequent to the date of the notice. The Commissioner shall within 30 days after such hearing make an order determining the proper Inheritance tax due.

This review procedure outlined in the above paragraph is also to be utilized in cases where a representative has been appointed and non-probate assets are reflected in the Inheritance tax return filed for the purpose of determining all matters relating to the taxability of non-probate assets except valuation. Whenever there are probate proceedings and a representative appointed, the valuation of all assets is to be determined by the Probate Court in accordance with the provisions of M.S. § 291.09, Subdivision 1.

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(c) Duplicate Returns Not Required. M.S. § 291.09, Subd. 2 (c) provides that any person liable for a tax under Chapter 291 need not individually file a schedule of non-probate assets and an Inheritance tax return if the transfers which gave rise to his tax liability are included in a schedule in non-probate assets and Inheritance tax return previously filed by another person with the Commissioner.

Inh Tax 193 Commissioner to Make and File Return. M.S. § 291.09, Subd. 3, provides that the Commissioner shall, in situations where an Inheritance tax return is required to be filed under the provisions of M.S. § 291.09 but such return has not been filed within 18 months after the decedent's death, make and file an Inheritance tax return and compute the tax due resulting from the transfers shown upon said return. The Commissioner upon the making of such return shall mail copies to the representative of the decedent's estate if any has been appointed and to each person from whom any portion of tax is due.

Any interested person may make objections to the return as filed by the Commissioner in accordance with the provisions of M.S. § 291.09 Subd. 1 (c), and Subd. 2 (b). The time limitations as set forth in Subdivision 1 and 2, mentioned above, shall commence with the mailing of copies of the Inheritance tax return by the Commissioner. Objections to any item included in an Inheritance tax return prepared by the Commissioner are to be made in the same manner as though the return in question had been filed by a representative who has been appointed, or any person from whom a tax is due. That is, if a representative has been appointed and probate proceedings have been commenced. All questions of valuations of assets both probate, and non-probate to which there is objection, shall be addressed to the Probate Court. In addition, objections to any other matter concerning probate assets are also to be directed to the Probate Court. In cases where no representative has been appointed and there are no probate assets, all objections as to valuations and all others shall be directed to the Commissioner of Taxation.

The fact that the Probate Court may have under the provisions of M.S. § 291.09, Subd. 1 (e) waived the filing of an Inheritance tax return does not preclude the Commissioner from filing a return in situations where information available to him indicates that a tax is due.

Inh Tax 194 Agreement to Utilize Federal Values. M.S. § 291.09, Subd. 5 provides that the Commissioner and the representative of the decedent's estate may agree that the valuations of assets established for purposes of the Federal estate tax on the decedent's estate shall be utilized for the purposes of determining the Inheritance tax.

A representative who desires to enter into such agreement with the Commissioner should execute in duplicate Form 1G3 and forward the same to the Commissioner for his consideration. If the Commissioner determines that such agreement should be entered into, he will subscribe to form and return one copy to the representative.

(CHAPTER EIGHTEEN: MAINTENANCE IS REPEALED)

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CHAPTER NINETEEN: INH TAX 206-210
COMPUTATION OF TAX

Inh Tax 206 In General. The state inheritance tax law is based upon the principle of taking a tax upon the amount of money value received by each beneficiary of the estate of a decedent. In accordance with M.S. § 291.03, the exemptions and the rates applied to each beneficiary are based upon the relationship of the decedent to the class of which such beneficiary is a member.

Inh Tax 207 Method of Computing Tax. The exemption is allowed against the money value of the property taxed in the lowest rate bracket. The amount in that bracket unabsorbed by the exemption is taxed at the rate applicable to that bracket. The remaining amount is then taxed at the rates applicable to the remaining brackets in ascending order. Where the beneficiary is the widow, the first bracket, which has a maximum of $25,000.00, is not sufficient to absorb the statutory $30,000.00 exemption. Therefore, the remaining $5,000.00 of the widow's exemption is applied against the second bracket.

The use of the table set out below, which gives effect to the exemptions and rates provided in M.S. § 291.03, is illustrated by the following examples:

EXAMPLE 1: H, husband, and W, wife, are joint owners of securities valued at $75,000.00, and a homestead valued at $25,000.00 free and clear of any debts or mortgages. H dies. The tax is computed as follows:

Total value of joint tenancy property passing to wife as surviving owner is	$100,000.00
Less homestead exemption	25,000.00
Taxable	$ 75,000.00

Examining the tax table opposite the relationship of Class I (a), it is seen that the sum of $75,000.00 lies between $50,000.00 in Column A and $100,000.00 in Column B and that $75,000.00 is $25,000.00 in excess of the amount of Column A. The amount of tax is computed from the same line under Columns C and D in the following manner:

Tax from Column C	$ 400.00
Plus 3% from Column D (of excess of $25,000.00)	750.00
Total tax	$1,150.00

EXAMPLE 2: S, son, received $20,000.00 under a decree of distribution of the Probate Court.

Examining the table opposite the relationship of Class II it is seen that the sum of $20,000.00 lies between $6,000.00 in Column A and $25,000.00 in Column B, and that $20,000.00 is $14,000.00 in excess of the amount in Column A. The amount of tax is computed from the same line under Columns C and D in the following manner:

Tax from Column C	$ 0
Plus 2% from Column D (of excess of $14,000.00)	280.00
Total tax	$280.00

EXAMPLE 3: D, minor daughter of decedent, is beneficiary of a trust fund valued at $2,000,000.00.

Examining the table opposite the relationship of Class I (b) it is seen that

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the value of the estate is in excess of the $1,000,000.00 of Column A. The amount of tax is computed as follows:

Tax from Column C	$ 72,650.00
Plus 10% from Column D (of excess of $1,000,000.00)	100,000.00
Total tax	$172,650.00

Tax Table

The statutory exemption is automatically allowed in this table. The amount of the exemption (as provided in M.S. § 291.05, Clauses 3 through 7) applicable is stated in the column Relationship of Beneficiary to Decedent.

Rates and Exemptions (Effective July 1, 1959).

Relationship of Beneficiary to Decedent	For amount taxable: Which equal A	But do not exceed B	The tax is: The amount in this column C	Plus these percentages of the excess over the amount in Column A D
Class I (a): Widow	$ 30,000	$ 50,000	$ 0.00	2%
SPECIFIC EXEMPTION	50,000	100,000	400.00	3%
$30,000	100,000	150,000	1,900.00	4%
	150,000	200,000	3,900.00	5%
	200,000	300,000	6,400.00	6%
	300,000	400,000	12,400.00	7%
	400,000	500,000	19,400.00	8%
	500,000	1,000,000	27,400.00	9%
	1,000,000		72,400.00	10%
Class I (b): Minor or dependent child of the decedent, or any minor or dependent legally adopted child	$ 15,000	$ 25,000	$ 0.00	1½%
	25,000	50,000	150.00	2%
	50,000	100,000	650.00	3%
	100,000	150,000	2,150.00	4%
SPECIFIC EXEMPTION	150,000	200,000	4,150.00	5%
$15,000	200,000	300,000	6,650.00	6%
	300,000	400,000	12,650.00	7%
	400,000	500,000	19,650.00	8%
	500,000	1,000,000	27,650.00	9%
	1,000,000		72,650.00	10%
Class II: Husband, adult child, or other lineal descendant of the decedent, adult legally adopted child or issue, lineal ancestor of the decedent or mutually acknowledged child	$ 6,000	$ 25,000	$ 0.00	2%
	25,000	50,000	380.00	4%
	50,000	100,000	1,380.00	6%
	100,000	150,000	4,380.00	7%
	150,000	200,000	7,880.00	7%
	200,000	300,000	11,380.00	8%
SPECIFIC EXEMPTION	300,000	400,000	19,380.00	8%
$6,000	400,000	500,000	27,380.00	9%
	500,000	1,000,000	36,380.00	9%
	1,000,000		81,380.00	10%
Class III: Brother or sister or a descendant of a brother or sister of the decedent, wife or widow of a son, husband of a daughter of decedent	$ 1,500	$ 25,000	$ 0.00	6%
	25,000	50,000	1,410.00	8%
	50,000	100,000	3,410.00	10%
	100,000	150,000	8,410.00	12%
	150,000	200,000	14,410.00	14%
SPECIFIC EXEMPTION	200,000	300,000	21,410.00	16%
$1,500	300,000	400,000	37,410.00	18%
	400,000	500,000	55,410.00	20%
	500,000	1,000,000	75,410.00	22%
	1,000,000		185,410.00	25%
Class IV: Persons in any other degree of collateral consanguinity than the above	$ 500	$ 25,000	$ 0.00	8%
	25,000	50,000	1,960.00	10%
	50,000	100,000	4,460.00	12%
SPECIFIC EXEMPTION	100,000	150,000	10,460.00	14%
$500	150,000	200,000	17,460.00	16%
	200,000	300,000	25,460.00	18%
	300,000	400,000	43,460.00	20%
	400,000	500,000	63,460.00	22%
	500,000	1,000,000	85,460.00	26%
	1,000,000		215,460.00	30%

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CHAPTER TWENTY: INH TAX 211-215

TIME LIMITATIONS

Inh Tax 211 Generally. As a general rule, M.S. § 291.09, and Inh Tax 191 and 192, limit the period during which the tax liability reflected on the self-assessed inheritance tax return may be recomputed. However, M.S. § 291.11, Subd. 1(b), provides certain exceptions to this rule:

(a) Where a false or fraudulent return with the intent to evade the tax is filed, any additional tax may be assessed at any time. Whether the return as filed is deemed to be false or fraudulent depends upon the facts.

(b) Where a return required to be filed under M.S. 291 has not been filed, the tax may be assessed at any time.

EXAMPLE: F and S, father and son, held Blackacre as joint tenants. F died in 1963. In 1969, S requested a tax clearance as he was contemplating selling the property. Although more than four years had elapsed since F's death, the Commissioner assessed an inheritance tax based upon the values existing at date of F's death.

(c) The tax on items subject to tax but omitted from the return may be assessed at any time. Where the person filing the return claims that an item is not subject to tax, but discloses on the return all the relevant information relating thereto, such item will not be deemed to be an omitted item.

EXAMPLE: Representative, on Exhibit 4 of the Schedule of Non-Probate Assets, reports a transfer of $100,000 worth of securities made by the decedent in trust for the benefit of D, his daughter. Representative submits a copy of the trust instrument and claims that no inheritance tax is due as the trust was irrevocable. After the statutory period for objections had elapsed, the Commissioner ascertained that the value of the trust was properly included in the taxable return as the decedent had retained the right to revoke the trust. The value of the securities at the time of decedent's death was $500,000. Inasmuch as the return submitted by D, and the trust instrument accompanying the return contained sufficient information to enable the Commissioner to redetermine the tax, the Commissioner may not make such a redetermination as the statutory period for objecting had elapsed.

Inh Tax 212 Agreement to Follow Federal Determination and Extend Statute of Limitations. M.S. § 291.11, subd. 1(c), authorizes the Commissioner and the taxpayer (whether he be representative of the estate or a beneficiary of non-probate assets or a trustee) to enter into a written agreement extending the time for redetermining or adjusting the tax due. M.S. § 291.09, Subd. 5, provides that where the Commissioner and the representative agree in writing, values for purposes of the inheritance tax on both probate and non-probate assets shall be the same as those finally determined for purposes of the federal estate tax. Further, the Commissioner may agree in writing with said representative that federal determination will control as to other relevant matters regarding the Minnesota inheritance tax. However, any such agreement, whether as to values or other matters, shall be limited to those matters specifically set forth in the agreement.

Form IG-3 authorized by the Commissioner combines both of these agreements.

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EXAMPLE 1: Commissioner and Representative execute Form IG-3. The final federal determination increases the value of the principal of a revocable trust established by decedent. As the agreement contemplates that any change in the value of probate as well as non-probate assets made for federal estate tax purposes will control the value for purposes of the Minnesota inheritance tax, the Commissioner will assess additional inheritance taxes based upon such increased valuation.

EXAMPLE 2: Commissioner and Representative execute Form IG-3. The final federal determination does not change any of the values, but includes in the taxable estate the value of certain assets transferred by decedent during his lifetime, as gifts made in contemplation of death. These assets had been included in both the federal and Minnesota returns but had been claimed to be exempt from taxation. The Commissioner is precluded from assessing an inheritance tax on these assets as the taxability of such assets was not specifically included in the agreement, unless he proceeds pursuant to the limitation imposed under M.S. § 291.09.

EXAMPLE 3: Same facts as in Example 2. However, the Commissioner and the Representative agree that the federal determination as to whether the gifts are in contemplation of death will control for purposes of the Minnesota inheritance tax. Consequently, the Commissioner will assess additional taxes based upon this federal determination.

Form IG-3 is reproduced below.

Inh Tax 213 Limitation on Assessment of Minnesota Estate Tax. The Minnesota estate tax prescribed by M.S. § 290.34 is determined and assessed by the Commissioner of Taxation. Under M.S. § 291.11, Subd. 1(d) the Commissioner is required to assess the tax within 90 days after the representative or the taxpayer, as the case may be, has filed Form IG-13, Minnesota Estate Tax Return, together with a copy of the federal audit report or the federal closing letter accepting the federal return as filed. However, if a copy of the federal estate tax return, required to be submitted under M.S. § 291.09, Subd. 4, has not been furnished to the Commissioner, the 90 day period will not begin to run until the time such copy is submitted. See M.S. § 290.34 and Inh Tax 186 for information regarding the Minnesota estate tax return.

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CHAPTER TWENTY-ONE: INH TAX 216-218

DISCHARGE OF REPRESENTATIVE

Inh Tax 216 Responsibility of Representative for Payment of Tax. M.S. § 291.12, subd. 2, imposes personal liability for payment of inheritance taxes and interest accrued thereon on the representative or trustee who has in his possession or under his control any property to which the person required to pay the tax may be entitled to, provided the representative or trustee is aware that the tax is due thereon. The liability is limited to the extent of the value of the property in the hands of the representative or trustee. In addition, no liability for payment of the tax due or the interest accrued thereon is imposed upon the representative if the property cannot be used lawfully for payment of the amount due.

Subdivision 1 of this section requires that the representative or trustee who has possession or control of property which has been the subject of a taxable transfer shall either deduct the tax before transferring the property to the beneficiary entitled thereto, or collect the amount of the tax from such beneficiary, and thereafter shall pay any such tax over to the Commissioner.

Subdivision 3 of this section authorizes such a representative or trustee to retain any property in his possession or under his control until all taxes due thereon have been deducted or collected by him, or paid directly by the transferee to the Commissioner.

Under subdivision 4, the representative or trustee shall not be discharged until he has complied with the provisions of this section.

Accordingly, the Probate Court must find, in the language of M.S. § 525.504, that the representative "paid all taxes required to be paid by him and has filed proof thereof" in order to properly discharge him.

Pursuant to M.S. § 291.09, subd. 1(e), the Probate Court may waive the filing of any inheritance tax return where it determines that no tax is due. In such a case, the Court may, in its discretion, discharge the representative without any prior notice from the Commissioner to the effect that the representative has discharged his liabilities under M.S. § 291.12. If the Probate Court prefers that a letter of discharge be furnished, the Court should request such discharge at the time it files the waiver with the Commissioner.

Where an inheritance tax return has been filed, the Commissioner will notify the Court that no objection will be made to the discharge of the representative provided the representative's final account, together with the Court's order approving it, and the Court's decree of distribution, have all been filed with the Commissioner, and the Commissioner is satisfied that all inheritance taxes for which the representative is liable have been paid. The following examples are illustrative:

EXAMPLE 1: After all expenses of administration have been paid, the residue amounts to $60,000. Representative files an inheritance tax return and pays the Commissioner $1,160. S and D each have received $29,240. The Commissioner notifies the Probate Court that the representative has satisfied the provisions of M.S. § 291.12, by paying inheritance taxes in the amount of $1,160, and as a consequence, no objection will be raised if the Court discharges the representative.

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EXAMPLE 2: A representative reports on his inheritance tax return taxable transfers of $25,000 to N, nephew of the decedent. These transfers consist of a $5,000 legacy under the will and $20,000 insurance proceeds. Representative deducts $210 (the tax on $5,000 less the exemption of $1,500) and remits $4,790 to N. N, who lives in Paris, France, refuses to pay the inheritance tax of $1,200 due on the insurance proceeds. Representative will be held personally liable for the payment of the $1,200 inheritance tax on the insurance proceeds as he was aware that N was required to pay a tax on such proceeds, and the representative had sufficient funds under his control to pay the tax on the insurance proceeds.

EXAMPLE 3: Representative reports on his inheritance tax return taxable transfers of $26,000 to N, nephew of decedent. These transfers are represented by $1,000 legacy under the will and $25,000 in insurance proceedings. As N's exemption is $1,500, representative remits to him the entire legacy of $1,000. N, who lives in Paris, France, refuses to pay the inheritance tax of $1,490 due. Representative will be held liable for the value of the property held by him and to which N was entitled, that is, $1,000. He will not be responsible for the payment of the additional tax of $490.

EXAMPLE 4: D, decedent bequeathed $1,000 to N, his nephew, who lives in Paris, France. In due course, Representative makes a payment of $1,000 to N. Unknown to Representative, D had established a bank account in his name as trustee for N. At D's death, the proceeds of this fund (Totten trust) were paid over to N. Subsequent to the time Representative paid N the $1,000 bequest, the existence of the Totten trust is made known to Representative. The amount of tax owed by N is $1,490. However, as Representative was not aware that this tax was owed by N, he will not be held liable for payment thereof.

EXAMPLE 5: D's will leaves his probate estate to S, his son. W, widow, has previously consented in writing thereto. W, as surviving joint owner, receives securities in cash valued at $200,000. In addition, under M.S. § 525.15, W receives furniture, household goods and personal property valued at $3,000. Representative will not be liable for the inheritance tax owed by W as the property in his possession to which W is entitled (the property subject to selection by W) may not be legally withheld by him. (See Dun.Dig. [3rd Ed.] § 2731).

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CHAPTER TWENTY-TWO: INH TAX 219-222

RELEASE OF INHERITANCE TAX LIENS

Inh Tax 219 Liens for Inheritance Taxes.

(a) **In General.** M.S. § 291.14, subd. 1, imposes a lien upon all property subject to inheritance taxes. Under M.S. § 291.14, in order to enforce such a lien on real property subject to probate, the State must file a statement of its lien with the Register of Deeds (although not specifically stated in the law, by implication with the Registrar of Titles if the property be registered) of the county where such real property is located within ten years after the date of any final decree of distribution which may be entered in respect of the estate involved.

Accordingly, any person acquiring such real estate or any interest therein whether as a devisee or beneficiary of the decedent or by gift or by purchase takes such real estate or interest therein subject to the lien for inheritance taxes, except as provided for in clause (b) of this Regulation.

M.S. § 291.14, subd. 1, states:

> ". . . the person to whom such property is transferred shall be personally liable for such tax, until its payment, to the extent of the value of such property."

However, in respect of personal property, whether tangible or intangible, the lien does not extend to persons acquiring such property from the legatee or beneficiary, unless the transfer from the legatee or beneficiary to such person was made with the intention of avoiding the tax due.

(b) Release of lien on probate assets. M.S. § 525.481 authorizes the Probate Court, in its decree of final distribution, to waive the inheritance tax lien on the property distributed, although this section does provide that the decree shall not be entered until inheritance tax shown by the return to be due has been paid, nor shall the decree be entered until objections by the Commissioner to the return have been heard and determined unless the Court, in its discretion, determines that the entry of the decree will not jeopardize the collection of additional inheritance tax for which the representative is liable.

Where a representative, under a power contained in the will, or pursuant to an order of the Probate Court, conveys an interest in real estate on which a lien for unpaid inheritance taxes has been imposed, the purchaser, mortgagor or lessee acquires his interest free from the lien, under Sec. 525.693. The interest of the Commissioner in respect of such inheritance taxes are protected by the provisions of M.S. § 291.12 and Inh Tax 216.

M.S. § 524.482, in authorizing partial distribution of estate, conditions entitlement to such a decree upon "determination and payment of inheritance taxes sufficient to cover the property thereby distributed", and seems to require, in addition, the filing of "a bond satisfactory to the court . . . to secure the payment of unpaid . . . taxes" before permitting such a distribution.

M.S. § 525.481, in speaking of a final decree of distribution, states:

> "The court shall have the power in its decree to waive the lien of inheritance taxes on the property distributed and either the probate

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> court or the commissioner of taxation shall have the power to issue certificates waiving such lien or acknowledging payment of all such taxes and discharging the lien at any time."

The underlined language applies only to probate assets and to lien waivers incident to final distribution.

(c) Release of lien on non-probate assets. M.S. § 291.005 defines non-probate assets as follows:

> "Non-probate assets means and includes all property of every kind transferred from a decedent or at or by reason of the decedent's death which is subject to the inheritance tax imposed by this chapter . . . and which does not consist of probate assets."

Inh Tax 113, relating to the disclaimer procedures lists property that usually passes by reason of death of a decedent and states whether such property is a probate or non-probate asset.

Although M.S. § 291.14, subd. 1, provides that "every tax imposed by this chapter shall be a lien upon the property embraced in any inheritance, tax devise, bequest, legacy or gift until paid," there is no general statutory provision authorizing the waiver of the inheritance tax lien upon non-probate assets comparable to the provisions of M.S. §§ 525.481 and 525.482 authorizing such waivers in the case of probate assets. Consequently, statutes applicable to the several classes of non-probate property taxable under M.S. § 291 must be referred to for purposes of ascertaining the method of releasing the lien.

M.S. § 291.14, subd. 2, addresses itself to the method of releasing the lien on real property transferred to surviving joint tenants, and on real property transferred by decedent during his lifetime on which an inheritance tax is due by reason of his death.

M.S. § 291.19, subd. 1, requires any foreign executor, administrator or trustee to pay the tax due thereon before transferring stocks or other obligations. As M.S. § 291.01, subd. 1(4), specifically exempts from inheritance taxes intangibles owned by a person who was a non-resident at death, M.S. § 291.19, subd. 1, refers to (1) decedent who was a beneficiary of a trust held by a foreign trustee, and (2) stocks and bonds owned by a non-resident decedent at his death where the consent of the Commissioner is required in order to transfer such property pursuant to M.S. § 291.20, subd. 3. However, such consent in the case of bank accounts and securities of Minnesota corporations is no longer required pursuant to M.S. § 291.19, subd. 5.

M.S. § 291.20, subd. 1, provides that funds in the names of decedent and others, funds in the name of decedent as trustee for others (this refers to the so-called "Totten trust"), and securities held in joint tenancy by decedent and others may not be surrendered until ten days after notice of the transfer is served upon the county treasurer. This section also provides that where the decedent had access to a safe-deposit box, the contents of the box must be inventoried in the presence of the county treasurer prior to the release of such contents to a person authorized to take possession thereof.

M.S. § 291.20, subd. 3, provides that any corporation organized under the laws of Minnesota shall not transfer on its books or on its records, kept as

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transfer agent for any corporation, shares of stock in the name of a decedent known to be a resident of Minnesota at his death, without securing the prior consent of the Commissioner.

M.S. § 291.01, subd. 5, requires that an insurance company paying insurance proceeds or death benefits to a beneficiary in excess of $1,000 or transferring any unpaid balance or any interest in an annuity contract or deposit shall notify the Commissioner within ten days of such payment or transfer, on a form prescribed by him.

The following rules consistent with the various provisions of M.S. Chapter 291, discussed above, are applicable:

(a) Insurance proceeds may be paid over to the named beneficiary by the insurer without securing the prior consent of the Commissioner; however, where the amount is in excess of $1,000, notification of such payment or transfer must be made to the Commissioner.

(b) Annuity payments or lump sum payments in lieu thereof may be paid over to a contingent or secondary annuitant by the person or organization required to do so without securing the prior consent of the Commissioner, but subject to notification of such payments to the Commissioner on a form prescribed by him.

(c) Funds held in the joint names of decedent and others or by the decedent as trustee may be paid over to the surviving joint owners or to the beneficiary of the funds held in trust ten days after the depository or other person in possession of such funds had duly notified the county treasurer thereof.

(d) Securities, held by decedent and others as joint tenants may be surrendered to the surviving joint owner ten days after the person in possession thereof has duly notified the Commissioner that such securities will be so surrendered.

(e)(1) Except as provided in (ii) below, the contents of a safe-deposit box to which the decedent had access shall not be surrendered by the depository to the person authorized to take possession until such contents have been inventoried in the presence of the county treasurer or a person authorized by the latter to perform this function.

(2) The rule in (i) above, in respect of inventorying the contents of a safe-deposit box in the presence of the county treasurer may be waived by the Commissioner, upon application made to him, provided the safe-deposit box is rented to an organization, association, partnership or other entity which grants authority to certain of its officers, members or agents to enter the safe-deposit box in furtherance of the business or activities of such organization, association, etc.

The application should contain the following information:

Name of the organization, association, partnership, etc., requesting the waiver; the type of activities in which applicant is engaged; the character of the property or documents usually stored in such safe-deposit box, and the names and titles of all to whom right of access to the box is given. In addition, a statement, under oath, that no personal property of any such officers, members or agents will be kept in such safe-deposit box.

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If the application is approved, the Commissioner will notify the applicant and the depository that the death of a person authorized to enter the safe-deposit box rented by the applicant will not require that the box be sealed pending an inventory thereof in the presence of a county treasurer. Such a letter will release all concerned from the liability imposed under M.S. § 291.20 for permitting entry into a safe-deposit box or for entering same.

(f) Where shares of stock of a Minnesota corporation are held in joint tenancy between decedent and others or by decedent as trustee for others, and where no tax is due, the surviving joint tenant or the beneficiary of the trust shall file a schedule of non-probate assets together with two copies of an affidavit of survivorship containing the description of the stock, the certificate numbers, and shares represented by each certificate so identified.

In addition, if an inheritance tax is due thereon, the surviving joint tenant or the trust beneficiary shall file an inheritance tax return and pay the tax due thereon.

If a tax clearance is desired prior to the time the inheritance tax return is filed, the person requiring the clearance should file Form IG-8, **Pre-Payment of Inheritance Tax on Specific Property** which is reproduced below.

(g) Where real estate, other than certain homesteads (see No. 8 following), is held in the names of decedent and others as joint tenants, or where real estate transferred by decedent during his lifetime is subject to inheritance taxes, the state must assert its lien by filing a statement of such lien within ten years from the date upon which a copy of the death record of the deceased joint tenant or deceased transferor together with a schedule of non-probate assets duly acknowledged by the Commissioner is filed in the office of the Register of Deeds or Registrar of Titles. As this involves a delay of ten years as well as the possibility that upon receipt of the required documents, the Commissioner will file the necessary papers asserting the lien, the surviving joint tenant or trust beneficiary may secure a prompt release of the state's lien by following the procedures set out in No. 6 preceding.

(h) Where the homestead is held in the names of decedent and spouse as joint tenants, the lien on the property will be extinguished by filing an affidavit, as prescribed by the Commissioner, with the Register of Deeds or the Registrar of Titles, in duplicate, together with a certified copy of the death certificate. In order to use this method of releasing the lien on such homesteads, the following conditions must be present:

(1) The surviving joint tenant was the spouse of the decedent at date of death;

(2) The property described as the homestead was owned and occupied by the decedent as his principal dwelling-place at date of death;

(3) The quantity of land included in such property was not in excess of the maximum amount allowed for purposes of the homestead exemption under M.S. § 510.02;

(4) The gross market value of such property at date of death was not in excess of $30,000. (Gross market value as used herein, is defined as the market value before giving effect to any liens, encumbrances or mortgages against the property.)

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(i) Where the homestead is held in the names of decedent and minor or dependent, natural or adopted child of decedent, or by a group consisting of decedent, spouse and such children as joint tenants, and decedent's death occurred subsequent to April 20, 1939, the lien may be extinguished in accordance with the provisions of No. 8 above. Under the law, the date of a minor child's birth must be stated on the affidavit.

(j) Where the homestead is held in the names of decedent and issue of the decedent, or by a group consisting of decedent, spouse and issue of decedent, and decedent's death occurred in the period beginning April 21, 1939 and ending April 25, 1949, the lien may be extinguished in accordance with the provisions of No. 8 preceding. The following examples are illustrative of paragraphs 8, 9 and 10, preceding:

EXAMPLE 1: Decedent and spouse held the homestead in joint tenancy on May 15, 1952. Gross market value of homestead was $15,000. Spouse can file an Exempt Homestead Affidavit in order to extinguish lien.

EXAMPLE 2: H, decedent, W, spouse, and S, their minor son, aged 19, held the homestead in joint tenancy. Decedent died September 1, 1960. Gross market value of homestead at date of death was $25,000. In 1969, spouse and son, who is now an adult, submit Exempt Homestead Affidavit to Register of Deeds. The Affidavit will extinguish the lien as son was a minor child at date of death of decedent.

EXAMPLE 3: H, decedent, W, spouse, and S, their minor son, aged 18, held homestead in joint tenancy. Decedent died in February, 1964. Gross market value of homestead at that time was $23,000. In 1969, W died. Value of homestead at that time was $28,000. The Exempt Homestead Affidavit submitted with respect to the death of H will release the lien that attached at H's death as S was a minor at the time. However, as S was an adult child at the time of W's death, and W's death occurred subsequent to April 25, 1949, the Exempt Homestead Affidavit may not be used as it will not extinguish the lien which attached at W's death. M.S. § 291.05(2) does not exempt from inheritance tax homesteads passing to an adult child where death of the decedent occurred subsequent to April 25, 1949.

EXAMPLE 4: H and W held homestead in joint tenancy. At H's death, the gross market value of the property was $$45,000. The property was mortgaged to the extent of $20,000, thus reducing the net value to $25,000. However, the Exempt Homestead Affidavit may not be used as the gross value of the property was in excess of $30,000.

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CHAPTER TWENTY-THREE: INH TAX 223-225

ACCRUAL OF INTEREST ON UNPAID INHERITANCE TAXES

Inh Tax 223 In General. M.S. § 291.15 requires that accrued interest be imposed on the unpaid portion of the inheritance taxes that may be due and owing at the expiration of 18 months after the death of the decedent. There is no provision in the law which will permit the Commissioner of Taxation to waive the interest regardless of the reasons for the delay involved in making payment of the tax.

Inh Tax 224 Payments made prior to January 1, 1964.

(a) In the event that the inheritance tax has not been determined at the expiration of 18 months, the taxpayer may petition the Probate Court, if the estate is subject to probate proceedings, for permission to prepay to the County Treasurer the amount of inheritance taxes that the taxpayer believes will be due and owing. If there are no probate proceedings, the taxpayer may request the Commissioner to issue an order authorizing a prepayment. To the extent of the amount so prepaid no interest will thereafter accrue.

(b) In the event that the amount so prepaid exceeds the amount of inheritance tax finally determined, the taxpayer may submit a verified petition requesting the refundment of the excess. Such refundment shall be made without interest.

(c) As prepayment of the amount of taxes estimated to be owed constitutes a deposit against the taxes owed and not a payment of the tax, the two year limitation of the time in which to file a petition for refund provided for in M.S. § 291.18 does not apply.

Inh Tax 225 Payments made on or after January 1, 1964. In all cases prepayments of the inheritance tax made on or after January 1, 1964 shall be made directly to the Commissioner of Taxation at his office in St. Paul, Minnesota. Permission to make a prepayment shall be automatically granted when the remittance representing such prepayment is accompanied by a form prescribed by the Commissioner of Taxation.

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CHAPTER TWENTY-FOUR: INH TAX 226-227

DISPUTED DOMICILE AGREEMENT BETWEEN STATES

Inh Tax 226 In the case where Minnesota and one or more other states each claims that it was the domicile of a decedent, the Commissioner may elect to invoke the provisions of M.S. § 291.41 through 291.47, and enter into a written agreement with the proper taxing official of such other state or states, and with the executors, to accept a certain sum in full payment of the death taxes.

Inh Tax 227 The amount of tax due and payable to the State of Minnesota shall be computed in the following manner:

(a) The tax shall be computed and determined in the same manner as though the decedent had been domiciled in and a resident of Minnesota at the time of his death.

(b) The value of all tangible property, real, personal, or mixed, or any interest therein subject to Minnesota inheritance taxes, plus the value of that portion of the intangibles represented by dividing the full value of such intangibles by the number of states involved in the agreement shall be the numerator of a fraction. The denominator of such fraction shall be the total values employed in the first step.

(c) The tax as computed in the first step shall be multiplied by the ratio of the fraction as computed in the second step. The tax as so computed shall be the tax paid to Minnesota. If the aggregate amount payable under such an agreement is less than the credit allowable to the estate against the United States estate tax imposed with respect to such estate, the executor shall pay to Minnesota the same percentage of the difference between such aggregate amount of such credit as the amount payable to Minnesota under such agreement bears to such aggregate amount.

EXAMPLE 1: H owned rental property in Minnesota valued at $50,000.00. In addition, he had cash and securities in California valued at $80,000.00. His entire estate was bequeathed to W, his widow. Both Minnesota and California had reasonable grounds upon which to assert a claim that the decedent had been domiciled in and a resident of their respective states. The two states and the executors of H's estate entered into an agreement to settle the matter amicably. Expenses of the probate were $10,000.00.

The computation is as follows:

Step (1) $50,000.00 + 80,000.00 — 10,000.00 = $120,000.00
Tax on $120,000.00 to a widow is 1,200.00
Tax on $120,000.00 to a widow is

Step (2) $50,000.00 + ½ (80,000.00 — 10,000.00) = 85,000.00

$$\frac{50{,}000.00 + 80{,}000.00 - 10{,}000.00}{\$120{,}000.00} = 70.83\%$$

Step (3) $1,200.00 × 70.83% = $850.00 tax to be paid to Minnesota.

EXAMPLE 2: At X's death New York, Florida and Minnesota each had reasonable grounds upon which to assert a claim that the decedent had been domiciled in and a resident of their respective states. The aggregate

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amount of inheritance taxes payable under an agreement entered into by the three states was $360,000.00; the credit for state death taxes allowed by the federal government was $424,800.00; the amount of inheritance taxes payable to Minnesota based upon a computation similar to the one made in Example 1 was $90,000.00. Subtracting from the federal credit of $424,800.00 the aggregate payable to the three states, namely $360,000.00 results in a total estate tax payable of $64,800.00. The amount due and payable to Minnesota is represented by $\frac{\$\ 90,000.00}{360,000.00}$ multiplied by $64,800.00.

The additional amount payable to Minnesota as a result of this computation is $16,200.00. The total due and payable to the State of Minnesota is $90,000.00 + $16,200.00 or $106,200.00.

Citations and references to Section or Minnesota Statutes etc. are references to M.S. §. Citations and references to Inheritance Tax Regulations or Inh Tax Regs or Regs are references to regulations properly cited as Inh Tax xxx.

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MINNESOTA DEPARTMENT OF REVENUE

Rules and Regulations Relating to Local Government Levy Limitations

Rev LL 1 Introduction. Minnesota Statutes, Sections 275.50 to 275.56, hereinafter referred to as the Levy Limitation Law, imposes levy limitations on certain local units of government. Minnesota Statutes, Section 275.58 provides the procedure for elections to increase levies, without penalty, above the limits established by Minnesota Statutes, Sections 275.50 to 275.56. Minnesota Statutes, Section 275.59 exempts certain governmental subdivisions from the provisions of Minnesota Statutes, Ssections 275.50 to 275.56.

Rev LL 2 Definitions. Section 275.50, Subdivision 1 states, "As used in Sections 275.50 to 275.56, the terms defined herein have the meanings given to them." Terms not specifically defined in the Levy Limitations Law or in these regulations will be given the meaning ascribed to them in accordance with legal, governmental finance, accounting, or common usage.

Rev LL 3 Governmental Subdivision. The term "governmental subdivision" is defined in Section 275.50, Subdivision 2 as "any county, city, village, borough, or town having the powers of a village pursuant to Minnesota Statutes 1971, Section 368.01 or Section 368.61, or by special law." School districts, towns without village powers, and special taxing districts are specifically excluded from the term "governmental subdivision."

For the purpose of the Levy Limitations Law, those towns granted village powers by special law shall be deemed to be "governmental subdivisions" only if such special law adopts, by reference, all of the provisions of Minnesota Statutes, Section 368.01 or Minnesota Statutes, Section 368.61. All other towns granted village powers by special act shall not be deemed to be "governmental subdivision.":

The Department of Revenue has determined that the following are "special taxing districts" and are thereby excluded from the term "governmental subdivisions":

(a) Metropolitan Mosquito Control District (Minnesota Statutes 1971, Chapter 399);

(b) Hospital districts (Minnesota Statutes 1971, Sections 355.80, 447.34, 447.35, 447.476; Laws of Minnesota 1957, Chapter 3; Laws of Minnesota 1961, Chapter 372; Laws of Minnesota 1963, Chapters 118 and 276);

(c) Housing and redevelopment authorities (Minnesota Statutes 1971, Sections 462.425 to 462.575; Laws of Minnesota 1961, Chapter 200); except that if the Housing and Redevelopment Authority is a department within a municipal or county government, or has public officers or employees of such government serving as the commissioner of such authority, the governing body in which such Housing and Redevelopment Authority principally operates may petition the Commissioner of Revenue for a determination that the Housing and Redevelopment Authority is an integral part of such municipal or county government. If the Commissioner, in response to such

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request, determines that the Housing and Redevelopment Authority is an integral part of such municipal or county government, the Housing and Redevolpment Authority shall not be considered to be a special taxing district and shall furthermore be subject to the levy limitations of such municipal or county government;

(d) Metropolitan Airports Commission (Minnesota Statutes 1971, Sections 360.101 to 360.144);

(e) Metropolitan Council (Minnesota Statutes 1971, Section 473.11 and Chapters 473B and 473C);

(f) Metropolitan Transit Commission (Minnesota Statutes 1971, Chapter 473A; Laws of Minnesota 1971, Chapter 830, Sections 6 and 12);

(g) Park districts (Minnesota Statutes 1971, Sections 398.01 to 398.21; Laws of Minnesota 1971, Chapter 954);

(h) Port authorities (Minnesota Statutes 1971, Sections 458.09 to 458.1991);

(i) Regional development commissions (Minnesota Statutes 1971, Sections 462.381 to 462.396; Laws of Minnesota 1971, Chapter 153);

(j) Regional sanitary sewer districts (Minnesota Statutes 1971, Sections 115.61 to 115.67);

(k) Dover, Eyota and St. Charles Area Sanitary District (Laws of Minnesota 1973, Chapter 160);

(l) St. Cloud Metropolitan Transit Commission (Laws of Minnesota 1969, Chapter 1134);

(m) Sanitary districts (Minnesota Statutes 1971, Sections 115.18 to 115.37 and Section 115.46; Laws of Minnesota 1971, Chapter 824);

(n) Alexandria Lake Area Sanitary District (Laws of Minnesota 1971, Chapter 869);

(o) Western Lake Superior Sanitary District (Laws of Minnesota 1971, Chapter 478);

(p) Watershed districts (Minnesota Statutes 1971, Chapter 112; Laws of Minnesota 1971, Chapter 662).

All of the aforementioned taxing districts are deemed to be "special taxing districts" since they are political entities and taxing entities separate from any county, city, village, borough or town with village powers.

The boards and commissions of a county, city, village, borough or town with village powers are not separate "governmental subdivisions" for the Levy Limitations Law, but instead are included in such county, city, village, borough or town with village powers governmental subdivision.

Example 1. County park boards and county hospital boards are not "governmental subdivisions."

Example 2. County library boards are not "governmental subdivisions" even though the ad valorem levy for them may not be county-wide (i.e., the mill rate may not be applied in certain assessment districts).

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Rev LL 4 Governing Body of a Town. The term "governing body" of a town is defined in Section 275.50, Subdivision 3, as the board of supervisors of the town.

Rev LL 5 Special Assessments. The term "special assessments" is defined in Section 275.50, Subdivision 4 as those "assessments made against real property for purposes of financing, wholly or in part, only those types of improvements enumerated in Minnesota Statutes 1971, Sections 429.021, Subdivision 1 and 429.101, whether imposed pursuant to such sections or pursuant to home rule charter provisions." General tax levies to finance the aforementioned improvements which are spread upon real estate not specifically benefited by the improvements, and on the benefited real estate as part of the taxable valuation of the governmental subdivision, are not considered special assessments.

Example 1. An ad valorem levy by rate in a city, village, borough or town to pay the cost of a judicial ditch, county ditch, or joint county ditch assessment against such city, village, borough or town is not a "special assessment" because it is a mill levy and it is imposed on more than the specifically benefited property.

Example 2. General obligation improvement bonds are issued by a governmental subdivision to pay the cost of street and curbing improvements. The bond agreement specifies that 80% of bond principal and interest is to be repaid by ad valorem levy and 20% is to be repaid by special assessments on benefited property. In this instance, only the 20% of the cost of bond principal and interest raised by special assessments against benefited property is included in the term "special assessments" as used in the Levy Limitations Law. However, the remaining 80% of bond principal and interest raised by ad valorem levy would qualify as a "special levy" outside the levy limitations imposed by the Levy Limitations Law. (See Rev LL 16 below for bonded indebtedness special levies.)

If a general or special law enacted after 1971 provides that a governmental subdivision must finance certain improvements by an ad valorem tax levy, when improvements of such type were financed by special assessments in levy year 1970, taxes payable in 1971, the governmental subdivision's levy limit base per capita is adjusted to reflect the change in financing. (See Rev LL 32 for adjustments to the base for public improvements required to be financed by ad valorem taxation and which previously were financed by special assessments.)

Rev LL 6 Special Levies. The term "special levies" is defined in Section 275.50, Subdivision 5 as those portions of ad valorem taxes levied by governmental subdivisions for the purposes enumerated in Section 275.50, Subdivision 5. (See Rev LL 7 through Rev LL 26 for the rules concerning the several "special levies.") These "special levies" are not subject to the levy limitations imposed by the Levy Limitations Law.

The term "special levies" does **not** include a levy claimed for any of the purposes enumerated in Minnesota Statutes, Section 275.50, Subdivision 5 when such levy is intended to be used for some other purpose. The term "special levies" also does **not** include a levy claimed for any of the purposes enumerated in Minnesota Statutes, Section 275.50, Subdivision 5, when such levy is in actuality an unused or unclaimed authorized "special levy"

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for a previous levy year, but which was levied in such previous levy year subject to the levy limitation of the governmental subdivision for such levy year as established pursuant to Minnesota Statutes, Sections 275.50 to 275.56.

For the purpose of determining the "special levies" pursuant to Section 275.50, Subdivision 5, and for the purpose of the rules Rev LL 7 through Rev LL 26 of these rules and regulations, the term "'levy" or "levies" shall have the following meanings:

(a) For levy year 1970, taxes payable in 1971, the term "levy" or "levies" or "amount levied" shall mean the ad valorem tax voted by the governing body of the governmental subdivision and certified to the county auditor, before any reduction by the Exempt Property Reimbursement paid pursuant to Minnesota Statutes 1969, Section 273.69; and

(b) For levy years 1971 and thereafter, taxes payable in 1972 and thereafter, the term "levy" or "levies" or "amount levied" shall mean the ad valorem tax voted by the governing body of the governmental subdivision and certified to the county auditor.

Rev LL 7 Judgments. Levies to "satisfy judgments rendered against the governmental subdivision by a court of competent jurisdiction in any action other than an action on an express contract, or to pay the costs of settlements out of court against the governmental subdivision in any action other than an action on an express contract when substantiated by a stipulation for the dismissal of the action filed with the court of competent jurisdiction and signed by both the plaintiff and the legal representative of the governmental subdivision," are special levies to "the extent of the increase in levy for such judgments and out of court settlements over levy year 1970, taxes payable in 1971."

For the purpose of determining the special levy pursuant to Section 275.50, Subdivision 5 (a), the following items increase the special levy:

(a) A levy to pay the costs of court judgments and out of court settlements not paid either by liability insurance procured pursuant to Minnesota Statutes, Section 466.06 or by self insurance (from a contingency fund established for such purpose);

(b) A levy for the total premium costs of liability insurance procured pursuant to Minnesota Statutes, Section 466.06, excluding the premium costs of insurance for protection in excess of the limit of liability imposed by Minnesota Statutes, Section 466.04 and excluding any insurance procured to cover workmen's compensation claims;

(c) A levy for self insurance (contingency fund established for the purpose of paying court judgments and out of court settlements against the governmental subdivision), minus the amount of self insurance to be levied to cover workmen's compensation claims and minus the amount of unused self insurance levied in the immediately preceding levy year for all purposes except workmen's compensation.

For the purpose of determining the special levy pursuant to Section 275.50, Subdivision 5 (a), the following items decrease the special levy:

(a) The levy in 1970, taxes payable in 1971, to pay the costs of court judgments and out of court settlements;

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(b) The levy in 1970, taxes payable in 1971, for the total premium costs of liability insurance procured pursuant to Minnesota Statutes, Section 466.06, excluding the premium costs of insurance for protection in excess of the limits of liability imposed by Minnesota Statutes, Section 466.04 and excluding any insurance procured to cover workmen's compensation claims;

(c) The levy in 1970, taxes payable in 1971, for self insurance (contingency fund established for the purpose of paying court judgments and out of court settlements against the governmental subdivision) minus the amount of self insurance levied to cover workmen's compensation claims.

For the purpose of determining the special levy pursuant to Section 275.50, Subdivision 5 (a), the aforementioned items which increase or decrease the special levy are limited to those levies which cover or pay for tort liability within the scope of Minnesota Statutes, Sections 466.02 and 466.03 (excluding workmen's compensation claims) and within the maximum liability amounts specified in Minnesota Statutes, Section 466.04.

Example 1. A levy to pay the cost of a tort judgment for false arrest would be included in determining the special levy pursuant to Section 275.50, Subdivision 5 (a).

Example 2. A levy to pay the cost of a settlement out of court against a governmental subdivision in a condemnation of real estate proceeding, substantiated by a stipulation for the dismissal of the action filed with the court of competent jurisdiction and signed by both the plaintiff and the legal representative of the governmental subdivision, would be included in determining the special levy pursuant to Section 275.50, Subdivision 5 (a).

Levies to satisfy judgments or out of court settlements resulting from a governmental subdivision defaulting on its obligations under express contract are not "special levies" pursuant to Section 275.50, Subdivision 5 (a). For example, a levy to pay the cost of a judgment resulting from the default of a governmental subdivision to pay for services rendered for maintenance of streets under a previously agreed contract would not be included in determining the special levy pursuant to Section 275.50, Subdivision 5 (a). However, levies to satisfy judgments or out of court settlements against the governmental subdivision in actions on implied contracts are included in determining the special levy pursuant to Section 275.50, Subdivision 5 (a).

Rev LL 8 Lawful Orders. A levy to "pay the costs of complying with any written lawful order issued by the state of Minnesota, or the United States, or any agency or subdivision thereof, which is authorized by law, statute, special act or ordinance and is enforceable in a court of competent jurisdiction, or any stipulation agreement or permit for treatment works or disposal system for pollution abatement in lieu of a lawful order signed by the governmental subdivision and the state of Minnesota, or the United States, or any agency or subdivision thereof which is enforceable in a court of competent jurisdiction," is a "special levy" to the extent that such lawful order, stipulation agreement or permit requires a new or altered activity which results in an increase in expenditures.

Example 1. A levy to pay the cost of complying with an order from the Minnesota Department of Health, ordering the governmental subdivision to install fluoridation equipment to its waterworks system, would be a "special

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levy" to the extent of the additional expense resulting from such installation. Also, a levy to pay the cost of complying with an order to increase an existing fluoridation level would be a special levy to the extent of the additional expenditure for increased chemical usage or plant modification (excluding machine adjustment).

Example 2. A levy to pay the cost of closing a dump, in compliance with a stipulation agreement signed by the Minnesota Pollution Control Agency and the governing body of the governmental subdivision would be a special levy. However, the cost of a grader or tractor which was purchased to use in closing a dump may not be levied as a special levy under Section 275.50, Subdivision 5 (b). However, if such equipment was financed by bonds, or by certificates of indebtedness pursuant to Minnesota Statutes, Sections 412.301 or 411.50, the principal and interest on such bonds or certificates could be claimed as a special levy (See Rev LL 16 and Rev LL 17.)

Example 3. A city levy to pay the cost of complying with an order from the county government to take specific action with respect to applicable county ordinances established pursuant to the Solid Waste Management Act (Minnesota Statutes, Chapter 400) would be a special levy to the extent of the incremental cost attributable to such lawful order.

Example 4. A levy to pay the cost of starting and operating a sanitary landfill system which is authorized by a permit issued by the Minnesota Pollution Control Agency is a special levy to the extent of the increased costs for such sanitary landfill over the amount levied for a sanitary landfill system or dump in levy year 1970, payable 1971.

Example 5. A village has a written stipulation agreement with the Minnesota Pollution Control Agency to construct secondary and tertiary treatment facilities in order to comply with the Agency's rules and regulations. A levy to pay the cost of the village in complying with such stipulation agreement would be a special levy to the extent of the increased cost of the required activity over the levy for the same activity in 1970, taxes payable in 1971.

Example 6. The Federal Emergency Employment Act of 1971 requires that after the matching fund program has ended, the governmental subdivision must retain at least 50% of the employees hired under the Act. This requirement will be considered as a "stipulation agreement" for the purpose of the Levy Limitations Law. After the matching fund program under the Emergency Employment Act of 1971 is ended, the governmental subdivision may levy the salaries, expenses and other costs of such employees retained as a special levy.

Example 7. A levy to pay the costs of helmets and boots for an organized fire department in order to qualify for state aid to firetowns, under the State Fire Marshall's rules and regulations, is not a "special levy." Such a levy is not the result of a lawful order, stipulation agreement or permit requiring certain new equipment but instead is a voluntary levy.

For the purpose of the Levy Limitations Law, the "costs" to a governmental subdivision of complying with a permit issued for a disposal system for pollution abatement shall be deemed to include the user fee imposed on the governmental subdivision pursuant to Laws of Minnesota 1973, Chapter 748. Such "costs" shall also be deemed to include the user fee imposed, pursuant to the same law, on the operator of a privately owned solid waste

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disposal facility, when the contract between the governmental subdivision and the operator of the disposal facility is renegotiated to reflect the increased costs due to such user fee. This "special levy" shall be limited to the extent that such user fee is not paid by service charges, special assessments or any other non-ad valorem tax revenue.

Finally, a governmental subdivision cannot default on its financial obligations, get a court order or any other lawful order to levy an ad valorem property tax, and then levy such tax as a "special levy" under the Levy Limitations Law.

The Commissioner of Revenue shall, in consultation with other state departments and agencies, develop a suggested form which may serve as a model for all lawful orders issued by the State of Minnesota and its agencies or subdivisions.

Rev LL 9 Compliance With Laws of the Minnesota Legislature. Levies to "pay the costs of complying with any law enacted by the 1971 legislature or a prior or subsequent year's legislature which specifically and directly requires a new or altered activity after levy year 1970" is a special levy to the "extent of the increased cost for such activity after levy year 1970, taxes payable in 1971."

In order to qualify as a special levy, the language of such law must be mandatory and not permissive and must specifically and directly require a new or altered activity which necessarily results in increased expenditures for the governmental subdivision. In addition, it must be a law of the Minnesota legislature which does not require a new or altered activity until after levy year 1970, taxes payable in 1971. Finally, it cannot be a law which sets the standards that a governmental subdivision must meet in order to qualify for a state aid. Such a law does not specifically and directly require a new or altered activity, and compliance by the governmental subdivision with such standards is not mandated by the State.

Only the additional costs of the new or altered activity at the required level after levy year 1970, taxes payable in 1971 may be levied as a "special levy."

Example 1. A county government levy to pay the cost of its share of a detoxification center required by Laws of Minnesota 1971, Chapter 892 would be a "special levy."

Example 2. A levy to pay the cost of preparation and mailing of the notices to be sent out by the county assessor's office to the owners of taxable real estate, showing the increase in assessed value, as required by Laws of Minnesota 1971, Extra Session, Chapter 31, Article 23, Section 2 is a "special levy."

Example 3. A levy to pay the salaries and expenses of a building official, an activity specifically required by Laws of Minnesota 1971, Chapter 561 is a "special levy" to the extent that the costs as a result of this law exceed the 1970 payable in 1971 levy for such activity.

Example 4. Laws of Minnesota 1971, Chapter 403 provides that certain counties shall regulate solid waste collection, storage transportation and disposal facilities. The effect of this provision, if the regulation is a new activity, might be to force a county government into garbage collection.

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However, Chapter 403 does not specifically or directly require a county government to collect, transport and dispose of garbage. Therefore, a county government cannot claim a special levy for garbage collection, transportation and disposal under Section 275.50, Subdivision 5 (c). However, if such county government obtained a permit from the Minnesota Pollution Control Agency to operate a sanitary landfill site or facility, the cost of operating such sanitary landfill site or facility could be levied as a special levy under Section 275.50, Subdivision 5 (b). (See Rev LL 8 for lawful order special levies.) Furthermore, the increased cost for the **regulation** function over the 1971 budget level may be levied as a special levy to the extent that the increased cost of regulation is attributable to Laws of Minnesota 1971, Chapter 403.

Example 5. Laws of Minnesota 1973, Chapter 23, requires that unemployment compensation must be paid to employees who are laid off for reason of a strike or labor dispute, provided that the employee is not participating in such strike or dispute. A levy to pay the costs of unemployment compensation for these employees is a "special levy."

Example 6. A levy to pay the litigation costs and fees for indigents that are charged to the governmental subdivision by any court of the State of Minnesota, pursuant to Laws of Minnesota 1973, Chapter 205, is a "special levy."

Example 7. A levy to pay the cost of adopting a local flood management ordinance as required under Laws of Minnesota 1973, Chapter 351 is a "special levy."

Example 8. A levy by a governmental subdivision to pay the cost of adopting a local ordinance affecting the use and development of its shoreland, as required under Laws of Minnesota 1973, Chapter 379 is a "special levy."

Example 9. Laws of Minnesota 1973, Chapter 559 requires that before an amendment to a zoning ordinance may be adopted, involving changes in district boundaries affecting an area of five acres or less, mailed notice must be sent to the owners of property located within 350 feet (previously 200) from the property to which the amendment relates. A levy to pay the increased cost of mailed notices resulting from this law is a "special levy."

Example 10. Pursuant to Laws of Minnesota 1973, Chapter 604, a governmental subdivision acting as an acquiring authority shall provide all relocation assistance, services, payments and benefits required by the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 and any regulations adopted pursuant thereto by the United States Department of Housing and Urban Development or the United States Department of Transportation, even though Federal aid is not available. A levy by a governmental subdivision to pay the costs of such required relocation assistance, services, payments and benefits when Federal aid is not available is a "special levy."

Example 11. A levy to pay the costs of complying with the Minnesota Fair Labor Standards Act (Laws of Minnesota 1973, Chapter 721), is a "special levy" to the extent that the provisions of the law regarding minimum wages and overtime cause the level of payroll costs to the governmental subdivision to exceed the levy year 1972, taxes payable in 1973 level.

Example 12. A levy by a governmental subdivision to pay the cost of complying with occupational safety and health standards or regulations

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promulgated pursuant to Laws of Minnesota 1973, Chapter 732 is a "special levy."

Example 13. Laws of Minnesota 1973, Chapter 752 provides that the Governor of the State of Minnesota designates an "area of critical concern" by written order. After receiving notification of such designation, a local unit of government with an "area of critical concern" within its jurisdiction must adopt plans and regulations to protect the area. A levy to pay the cost of adopting such plans and regulations concerning an "area of critical concern" would be a "special levy."

Rev LL 10 Expanded County Court Systems. A levy by a county government to pay the costs of an expanded county court system is a special levy to the extent of the increase in costs to the county government, after subtracting the amount of the county's anticipated collections of fees, fines and forfeits from the county's share of total court costs, over the amount levied in support of a county court or a probate court in levy year 1970, taxes payable in 1971. In general, any additional cost to the county government over the payable 1971 budget level, remaining after the subtraction of the county's anticipated collections of fees, fines and forfeits in the taxes payable year, is a "special levy."

Example 1. A probate judge was salaried the first half of 1971 at the yearly rate of $16,500. After becoming county court judge on July 1, 1971, his salary was increased to $24,000 in accordance with Laws of Minnesota 1971, Chapter 951, Section 5. Thus his salary for calendar year 1971 was $16,500/2 + $24,000/2 = $20.250. For levy year 1971 taxes payable in 1972 the county government could include both the increase in annual salary for 1971 ($20,250 − $16,500 = $3,750) and the increase in annual salary for 1972 ($24,000 − $16,500 = $7,500) in determining the "special levy" pursuant to Section 275.50, Subdivision 5 (d). In subsequent years, only the increase in salary over the budget year 1971 level can be included in determining this "special levy."

Example 2. A county court becomes operative on July 1, 1972 and several new employees (bailiff, deputy and clerk for Clerk of Court's Office) are hired effective July 1, 1972. A 1971 levy payable in 1972 to pay the cost of the salaries for the last half of calendar year 1972 and their associated supplies and expenses for that period would be included in determining the "special levy" for the increased costs of an expanded county court system. In subsequent years the total levy to pay the salaries, supplies, and expenses of these new employees would be included in determining this "special levy."

Example 3. A county court judge reports that more employees are needed for the court and that new office space must be provided for them as a result of the expanded county court system. A levy to pay the cost of remodeling or new construction for office space for the new court employees would be included in determining the "special levy" for the increased costs of an expanded county court system.

Example 4. The estimated total cost of a county court for budget year 1974 is $300,000. County A's share of the cost is $180,000. The anticipated amount of fines, fees and forfeits which will be paid to County A in budget year 1974 is $45,000. Since County A levied $100,000 for its probate court in levy year 1970, taxes payable in 1971, it would be entitled to a $35,000

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"special levy" ($180,000 – $45,000 – $100,000) in levy year 1973, taxes payable in 1974, to pay the cost of an expanded county court system.

This special levy applies only to county governments. Cities, villages and boroughs may **not** claim as a "special levy" under Section 275.50, Subdivision 5 (d), a levy to pay the increased expenses for lawyers' services or to compensate for the loss of municipal court fines or the municipality's share of the fines collected by a justice of the peace, due to the elimination of a municipal court or a justice of the peace by the County Court Law (Laws of Minnesota 1971, Chapter 951). However, the loss of municipal court fines or the municipality's share of fines collected by a justice of the peace may be included in the calculation of the special levy pursuant to Section 275.50, Subdivision 5 (n). (See Rev LL 20 for decreased non-tax revenues.)

Rev LL 11 Employer's Contributions to Public Pension Plans. A levy to "pay amounts required by any public pension plan to the extent that operation of the Laws of the State of Minnesota or the United States governing such fund directly causes the level of governmental financial support to exceed the level of such support prior to July 1, 1971," is a special levy "provided that such increases are not the result of amendment by any means to the benefit plan after July 1, 1971, which required the approval of the governing body of the governmental subdivision."

To qualify as a special levy, the language of the law must be mandatory and not permissive and must specifically and directly require an increase in the level of governmental financial support over the level of such support prior to July 1, 1971.

In general any increase in levy for the minimum required employer's contribution to a public pension plan over the levy year 1970, taxes payable 1971 level is a special levy, if not the result of amendment by any means to the benefit plan after July 1, 1971, which required the approval of the governing body of the governmental subdivision. The laws relating to this special levy include:

(a) The Social Security Act, including Public Laws 92-5, 92-336, 92-603, 93-66 and any subsequent amendment to the act;

(b) Minnesota Statutes, Section 353.27, relating to the payment of employer contributions to the Public Employees Retirement Association.

(c) Minnesota Statutes, Section 353.65, relating to employer contributions to the "Public Employees Police and Fire Fund" of the Public Employees Retirement Association.

(d) Minnesota Statutes, Section 69.77 (the "Police and Firemen's Relief Association Guidelines Act of 1969").

(e) Any special or local acts of the Minnesota legislature which established local pension plans, and the amendments to such acts.

For purposes of the special levy pursuant to Section 275.50, Subdivision 5 (e), the increase in levy for employer contributions to a public pension plan is calculated as the total increase in the levy for the minimum required employer's contribution (pursuant to the forementioned laws) in the current levy year over the levy year 1970, taxes payable in 1971 level, without regard to whether or not a portion of such increased cost is attributable to salary increases or expanded manpower levels.

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No portion of the employer cost for employees' group insurance may be levied as a special levy under Section 275.50, Subdivision 5 (e).

Rev LL 12 Employer's Contributions to Volunteer Firemen's Relief Associations. A levy to pay the increase in amounts required in support of a volunteer firemen's relief association is a special levy if the increase in required amounts results from the operation of Minnesota Statutes, Section 69.772 or 69.773.

In effect, the levy for the minimum amount of employer contributions required in support of a volunteer firemen's relief association, pursuant to Minnesota Statutes, Sections 69.772 or 69.773 would be a special levy to the extent of the increase in levy over the amount levied in support of a volunteer firemen's relief association in levy year 1970, taxes payable in 1971. This special levy is calculated without regard to whether or not a portion of the required increase in employer's contributions is correlated with wage or salary increases or with an expansion of manpower levels.

Rev LL 13 Local Share of Matching Fund Programs. A levy to pay the costs to a governmental subdivision for its share of any program otherwise authorized by law, for which matching funds have been appropriated by the State of Minnesota or the United States, is a special levy, but only to the extent that the minimum required local share for the program exceeds the levy for the local share of the same program in levy year 1970, taxes payable in 1971.

Levies to pay a local share may be a "special levy" both in the case of a matching fund program with Federal or State grants fixed by ratio and also in the case of a matching fund program with flat amounts of Federal or State grants. However, the term "special levy," for the purpose of Section 275.50, Subdivision 5 (g), does not in any way pertain to levies associated with State highway trunk fund aids and similar type aids (except grants for the administrative costs of categorical welfare aids and general assistance programs and the costs of administration of social services and the purchase of social services) which do not specifically require a stipulated local share amount.

The amount of the allowable special levy shall be calculated for each matching fund program individually. Likewise, in the case of segmented projects, the amount of the allowable special levy shall be calculated for each matching fund project individually. Separate determination shall be made for each program or project whether old or new, different from all the rest or similar or identical to other programs or projects.

With the exception of the administration of categorical welfare aids, and general assistance programs and the administration of social services and purchase of social services, only that portion of a levy for a matching fund program local share shown in the final agreement as approved by the State of Minnesota or the United States, whichever has authority for final approval, can be used in determining this special levy. If a governmental subdivision levies in excess of its minimum required local share for the taxes payable year, the excess levy over the minimum required local share amount cannot be considered for a special levy. In determining this special levy, however, the governmental subdivision may include a levy to reimburse itself for revenues borrowed from other funds of such governmental subdivision or to pay the principal and interest on loans from private lending

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institutions or from agencies of the United States or the State of Minnesota, when such revenues or loans were expended on the minimum required local share of a matching fund program or project in the current or last preceding calendar year. This applies only if the governmental subdivision made expenditures on the minimum required local share of a matching fund program or project in anticipation of State or Federal grants and did not levy taxes payable in the current or last preceding calendar year for such program or project. A governmental subdivision may levy as a special levy the increase in levy for the minimum required local share of a matching fund program or project over the levy in 1970, taxes payable in 1971 for the same program or project. A governmental subdivision may levy as a special levy the entire minimum required share of a matching fund program or project if no levy was extended in 1970 for taxes payable in 1971 for such program or project.

A governmental subdivision may levy for a matching fund program or project in anticipation of State or Federal grants and consider the minimum required local share of such levy as a "special levy" to the extent that it exceeds the levy, if any, for the program or project in 1970, taxes payable in 1971. If the program or project is approved by the State of Minnesota or the United States, whichever has final authority, but the local share amounts for each year shown in the agreement are less than the amounts actually levied, the "special levies" will be adjusted down to the amounts shown in the approved matching fund program agreement. However, if the program is not approved, and no grants are forthcoming, the unspent balance of money so raised may be held in anticipation of a future grant. Otherwise such levies can no longer be considered as "special levies," and to the extent that the unspent balance exceeds the overall levy limitation for the governmental subdivision, it shall be subject to the Commissioner's administrative action pursuant to Section 275.55. (See Rev LL 45 for the Commissioner's administrative action.)

Example 1. A governmental subdivision hires several employees in 1971 under the Federal Emergency Employment Act of 1971. The federal government has appropriated funds to pay 8/9ths of the cost of the authorized program. This is the first year for the program and there were no levies made for it in 1970, taxes payable in 1971. The governmental subdivision now wants to levy taxes in 1971, payable in 1972 to cover both the unreimbursed, unfunded, local share expenditures of the current year and the local share for next year. Such levy for the minimum required local share for the two years would be a "special levy" for the Levy Limitations Law.

Example 2. A governmental subdivision will be installing police radio communications equipment under a matching fund program with the Governor's Crime Commission. The governmental subdivision wishes to levy in 1971 to pay its minimum required local share of the cost of such equipment in 1972. Such levy would be a "special levy."

Example 3. A county government spent $100,000 in 1970 in anticipation of grants from the United States for a matching fund program of land acquisition and improvements for the purpose of a county park. The matching fund program was given final approval by the United States in September of 1970. The authorized program provided for expenditures of $80,000 in each of the years 1970, 1971 and 1972. The minimum required local shares were to be $20,000 (25%) in 1970, $40,000 (50%) in 1971 and $60,000 (75%) in 1972. The county government levied $80,000 in 1970,

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taxes payable in 1971 to pay the cost of the stipulated local share of $40,000 for budget year 1971 and to reimburse its general fund for the cost of the program in 1970 which was not reimbursed by the Federal government ($100,000 — $60,000 = $40,000). Since the $80,000 levy in 1970 is in the county government's levy limit base per capita for levy year 1971 (see Rev LL 28 and Rev LL 29 for the determination of levy limits), and since this amount is greater than the minimum required local share of $60,000 for levy year 1971 payable in 1972, no amount can be taken as a special levy for this matching fund program in levy year 1971 payable 1972.

Example 4. A governmental subdivision spent money in 1972 in anticipation of funds from the United States for a matching fund program. A levy was made in 1972 for taxes payable in 1973 to reimburse the unfunded local share of expenditures for the program and to fund the expected local share for 1973, and was levied as a "special levy." In 1973 the Federal government denied approval of the matching fund program. In such a situation, the unspent balance of money raised by ad valorem levy for the program could be held in anticipation of some future grant and still be considered a "special levy." Otherwise, it would no longer be a "special levy" for the Levy Limitations Law, and to the extent that the unspent balance exceeded the overall levy limitation for the governmental subdivision in levy year 1972, it would be subject to the Commissioner's administrative action pursuant to Section 275.55.

Included in the special levy for matching fund programs is the entire levy for the local costs of administration of categorical aids and general assistance programs and the local costs of administration of social services and purchase of social services. Only county governments may claim a special levy for such welfare costs. The term "special levy" does not apply to any levy for the administrative costs of township welfare systems or the City of Minneapolis' welfare department. (The township system of poor relief and the City of Minneapolis' levy for poor relief were abolished by Laws of Minnesota 1973, Chapter 650, Article XXI.)

Certain laws, such as the Federal Emergency Employment Act of 1971 or the rules and regulations of an agency of the State of Minnesota or the United States might require that a governmental subdivision continue an activity or function established under a matching fund agreement after the State or Federal share has ended. The additional cost of maintaining the required level of such activity or function over the levy year 1970 payable 1971 local share amount could qualify as a special levy under Section 275.50, Subdivision 5 (b). (See Rev LL 8 for special levies resulting from lawful orders.)

Rev LL 14 Natural Disasters. A levy to pay the "expenses reasonably and necessarily incurred in preventing, preparing for or repairing the effects of natural disaster" is a special levy.

For the purpose of the Levy Limitations Law, "natural disaster" means the occurrence or threat of widespread or severe damage, injury or loss of life or property resulting from natural causes, including and limited to fire, flood, earthquake, wind storm, tornado, wave action, oil spill, or other water contamination requiring action to avert danger or damage, volcanic activity, drought or air contamination.

A levy to pay the costs related to any of the aforementioned "natural disasters" is a special levy whether levied to provide funds for preventative

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action, levied in anticipation of an imminent natural disaster or levied after a natural disaster has occurred to reimburse other funds of the governmental subdivision or to pay principal and interest on loans from State or Federal agencies.

Example 1. A city situated next to a major river wants to build permanent dikes and repair existing ones to prevent flooding of the city. The cost of building and repairing these permanent dikes could be levied as a special levy.

Example 2. A village wants to levy a tax to reimburse funds that were used to pay the cost of cleaning up after a tornado hit the village. This levy would qualify as a special levy.

The expenses of dutch elm disease eradication and tree removal and oak wilt eradication and tree removal do not qualify as natural disaster "special levies." Also, the additional cost of snow removal due to a greater than expected amount of snowfall does not qualify as a natural disaster "special levy." These natural phenomena are not included in the exclusive list of natural phenomena which may qualify as "natural disasters" for the Levy Limitations Law. Finally, the expenditures by a local civil defense unit which do not relate specifically to one or more types of qualifying "natural disasters," and any other activities which are of an on-going routine nature and are not immediately and directly related to a qualifying "natural disaster" do not qualify as special levies under Section 275.50, Subdivision 5 (h). A civil defense levy matched by Federal or State grants, however, might qualify as a special levy under Section 275.50, Subdivision 5 (g). (See Rev LL 13 for matching fund special levies.)

The Civil Defense Division of the State Department of Public Safety shall formulate standards by which the occurrence of a natural phenomena would be deemed a "natural disaster." These standards shall be confined to the exclusive list of natural phenomena which may qualify as a "natural disaster." Such standards shall relate to levels of damage, injury or loss of life or property.

Each claim for a natural disaster "special levy" shall be investigated by the Commissioner of Revenue and compared to the standards devised by the Civil Defense Division to determine if the natural phenomenon qualifies as a "natural disaster" by reason of the level of damage, injury or loss of life or property that has occurred or would occur if preventative action was not taken. The Commissioner of Revenue shall consult with the Civil Defense Division on all such claims before approving or denying any part or all of a special levy.

Rev LL 15 Cash Public Assistance Programs. A levy to pay the costs not reimbursed by the State or Federal government of payments made to or on behalf of recipients of aid under Minnesota Statutes, Sections 245.21 to 245.43 (Aid to the Disabled), Sections 256.11 to 256.43 (Old Age Assistance), Sections 256.49 to 256.71 (Aid to the Blind), Sections 256.72 to 256.87 (Aid to Families with Dependent Children), Chapter 256B (Medical Assistance), and Chapters 261, 262 and 263 (Poor Relief) is a special levy.

The entire levy by a county government for the actual aid payments to the recipients under the above programs is a special levy and thus outside the county government's levy limitation established pursuant to Sections 275.50 to 275.56. Levies to pay the costs of general assistance payments

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made to recipients pursuant to Laws of Minnesota 1973, Chapter 650, Article XXI are also outside the county government's levy limitation established pursuant to Sections 275.50 to 275.56.

This special levy does not apply to the county's administrative costs of categorical welfare aids and general assistance programs or the county's administrative costs of providing social services or the purchase of social services. These costs may be levied as a "special levy" under Rev LL 13. (See Rev LL 13 for matching fund special levies.)

A levy by a city, village, borough or town with village powers in 1971 payable 1972, or 1972 payable 1973, to pay the costs of payments to recipients under Minnesota Statutes 1971, Chapters 261, 262, or 263, is a special levy. Beginning with levy year 1973 and levy years thereafter, no levy by a city, village, borough or town for the purposes cited in Minnesota Statutes 1971, Chapters 261, 262 or 263, except a levy for a fund deficit remaining from calendar year 1973 or preceding calendar years' expenditures for poor relief, can be recognized as a special levy, due to the elimination of the township system of poor relief and the City of Minneapolis' levy for poor relief by Laws of Minnesota 1973, Chapter 650, Article XXI.

Rev LL 16 Principal and Interest on Bonded Indebtedness. The entire levy to pay the cost of principal and interest on bonded indebtedness is a "special levy" for the Levy Limitations Law. The amount of this special levy is the same amount that is excluded from the total ad valorem levy of the governmental subdivision in determining the 45% Homestead Credit and the Taconite Homestead Credit.

Effective for taxes levied in 1973 and levy years thereafter, a levy to reimburse for the amount of liquor store revenues used to pay the principal and interest due on municipal liquor store bonds in the calendar year immediately preceding the current levy year is a special levy. For the purposes of the Levy Limitations Law and the homestead property tax relief granted pursuant to Minnesota Statutes, Sections 273.13 and 273.135, such levy shall be considered as a levy for the principal and interest on bonded indebtedness. This means that the amount of this special levy is the same amount that is excluded along with other bonded indebtedness levies from the total ad valorem levy of the governmental subdivision in determining the 45% Homestead Credit and the Taconite Homestead Credit.

Example. A city owns and operates a municipal liquor store. In calendar year 1972, liquor store revenues are used to pay the principal and interest due in 1972 on the city's municipal liquor store bonds. In levy year 1973, taxes payable in 1974, the city may levy a tax to reimburse itself for the amount of liquor store revenues used to make such payments in 1972 and consider such levy as a bonded indebtedness "special levy."

Rev LL 17 Principal and Interest on Certificates of Indebtedness. A levy to pay the costs of principal and interest on certificates of indebtedness is a special levy, with the following exceptions. Levies to pay the costs of principal and interest on tax anticipation certificates of indebtedness, aid anticipation certificates of indebtedness, certificates issued to fund an insufficiency in receipts from taxes or other sources, or to fund extraordinary expenditures resulting from a public emergency, are not "special levies" under Section 275.50, Subdivision 5 (k). However, a qualified special levy to compensate

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for certain decreased non-tax revenues (see Rev LL 20) or a qualified special levy to pay the costs of preventing, preparing for or repairing the effects of a public emergency which qualifies as a "natural disaster" (see Rev LL 14) could be used to pay the principal and interest on certificates of indebtedness previously issued to fund such insufficiency in receipts or to fund the extraordinary expenditures resulting from such public emergency.

Example 1. A village financed the purchase of fire equipment by issuing certificates of indebtedness pursuant to Minnesota Statutes, Section 412.301. An ad valorem tax levy to pay the principal and interest on these certificates would be a special levy.

Example 2. A fourth class city operating under Minnesota Statutes, Chapter 411, financed the purchase of street maintenance equipment by issuing certificates of indebtedness pursuant to Minnesota Statutes, Section 411.50, Subdivision 2. An ad valorem tax levy to pay the principal and interest on these certificates would be a special levy.

For the purposes of the Levy Limitations Law and the homestead property tax relief granted pursuant to Minnesota Statutes, Sections 273.13 and 273.135, a special levy pursuant to Section 275.50, Subdivision 5 (k) shall be considered the same as a levy for the principal and interest on bonded indebtedness. This means that the amount of this special levy is the same amount that is excluded in addition with other bonded indebtedness levies from the total ad valorem levy of the governmental subdivision in determining the 45% Homestead Credit and the Taconite Homestead Credit.

Rev LL 18 Principal and Interest on Armory Construction Bonds. A levy to fund the payments made to the Minnesota State Armory Building Commission pursuant to Minnesota Statutes, Section 193.145, Subdivision 2, is a special levy to the extent that such payments are for the purpose of retiring the principal and interest on armory construction bonds.

For the purposes of the Levy Limitations Law and the homestead property tax relief granted pursuant to Minnesota Statutes, Sections 273.13 and 273.135, a special levy pursuant to Section 275.50, Subdivision 5 (l) shall be considered the same as a levy for the principal and interest on bonded indebtedness. This means that the amount of this special levy is the same amount that is excluded in addition with other bonded indebtedness levies from the total ad valorem levy of the governmental subdivision in determining the 45% Homestead Credit and the Taconite Homestead Credit.

Rev LL 19 Bonded Indebtedness Portion of Payments Made to Another Political Subdivision. A levy to fund the payments made to another political subdivision of the State of Minnesota is a special levy to the extent that such payments are used to retire the principal and interest on bonds or certificates of indebtedness of the type which qualify for a special levy pursuant to Section 275.50, Subdivision 5(k).

Example. A county government contracts with the board of directors of a city library, in accordance with Minnesota Statutes, Section 134.12, Subdivision 3, for the use of the library by the residents of the county outside the city. A county levy on the taxable value outside the city, for the purpose of payment to the city library board for the library service provided, and which is used by the library board to pay the principal and interest on library construction bonds, would qualify as a "special levy" under Section 275.50, Subdivision 5(m).

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For the purposes of the Levy Limitations Law and the homestead property tax relief granted pursuant to Minnesota Statutes, Sections 273.13 and 273.135, a special levy pursuant to Section 275.50, Subdivision 5(m) shall be considered the same as a levy for the principal and interest on bonded indebtedness. This means that the amount of this special levy is the same amount that is excluded in addition with other bonded indebtedness levies from the total ad valorem levy of the governmental subdivision in determining the 45% Homestead Credit and the Taconite Homestead Credit.

Rev LL 20 Compensation for Certain Decreased Non-Tax Revenues. Section 275.50, Subdivision 5(n) provides that a qualifying governmental subdivision may levy as a "special levy" the amount necessary to compensate for certain decreased non-tax revenues. These revenues are revenues from all public service enterprises, municipal liquor stores, licenses, permits, fees, fines and forfeits and no other.

"Public service enterprises," for the purpose of the Levy Limitations Law, are defined as governmental activities which are primarily (in excess of 50%) self-supporting on a user charge, service fee or admittance fee basis. In addition, the accounting for such activities must make it possible to show whether they are operated at a profit or loss in similarity to comparable private enterprises.

"Public service enterprises" includes, but is not limited to, water utilities, electric utilities, electric distribution systems, heat utilites, gas utilities, municipally owned cable television systems, public hospitals and public nursing homes.

"Revenues" from a public service enterprise or a municipal liquor store means the net income or loss of such public service enterprise or municipal liquor store, determined by subtracting total expenses (excluding any expenses taken as a "special levy" pursuant to Section 275.50, Subdivision 5, and excluding any bond principal not taken as a "special levy" pursuant to Section 275.50, Subdivision 5(j)) from total revenues, and before any contribution to or from the governmental subdivision. "Fees, fines, and forfeits" for a municipal court means the net amount remaining after subtracting total municipal court expenses from total collections of municipal court fees, fines, and forfeits. "Fines" for a justice of the peace means the net amount remaining after subtracting these amounts from the total collections of fines by the justice of the peace: (1) that portion of the fines which he retains, and (2) his expenses in performance of his duties which were reimbursed by the governmental subdivision.

The forementioned "revenues" of the governmental subdivision for the calendar year preceding the current levy year are aggregated and compared to the aggregate of these "revenues" for the governmental subdivision in calendar year 1971 to determine the decrease, if any, in these revenues from the calendar year 1971 level. The "revenues" for **all** public service enterprises must be included in this calculation. If there was a decrease, such amount is then divided by the population of the governmental subdivision in the preceding levy year, determined pursuant to Section 275.53. (See Rev LL 40 for determination of population and Rev LL 41 for governing population census or estimate.) If the resulting per capita amount is equal to or greater than two percent of the governmental subdivision's levy limit base per capita for the preceding levy year, the governmental subdivision shall qualify for the special levy pursuant to Section 275.50, Subdivision 5(n).

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If the resulting per capita amount is less than two percent of the governmental subdivision's levy limit base per capita for the preceding levy year, the governmental subdivision shall **not** qualify for the special levy pursuant to Section 275.50, Subdivision 5(n).

A qualifying governmental subdivison shall be allowed a special levy to compensate for the entire amount of the decrease in aggregate revenues as computed pursuant to Section 275.50, Subdivision 5(n).

Example. A city of 8,000 persons in 1972 (determined pursuant to Section 275.53) owns and operates a water utility and a municipal liquor store. The city also had a municipal court for the entire calendar year 1971. In calendar year 1971, the water utility had total revenues of $1,000,000 and total expenses of $850,000 for a "net income" of $150,000. In the same year the municipal liquor store had total revenues of $800,000 and total expenses of $700,000 for a "net income" of $100,000. Finally, the municipal court, in calendar year 1971, had total collections of municipal court fines of $100,000 and total municipal court expenses of $80,000 for net "fines" of $20,000. The aggregate of revenues from these three sources in calendar year 1971 was $270,000. In calendar year 1972, the water utility had total revenues of $1,100,000, and total expenses of $925,000 for a "net income" of $175,000. In the same year, the municipal liquor store had total revenues of $825,000 and total expenses of $760,000 for a "net income" of $65,000. Finally, the municipal court, which was abolished as of July 1, 1972 (due to the provisions of the County Court Law, Laws of Minnesota 1971, Chapter 951), had total collections of municipal court fines in calendar year 1972 of $50,000 and total municipal court expenses of $40,000 for net "fines" of $10,000. The aggregate of revenues from these three sources in calendar year 1972 was $250,000. The difference in aggregate "revenues" for the calendar years 1971 and 1972 is $20,000, a decrease for calendar year 1972. This decrease divided by the city's 1972 population of 8,000 is a per capita dollar amount of $2.50. This per capita amount is 5% of the city's 1972 payable 1973 levy limit base per capita of $50.00. Since the per capita decrease of $2.50 is in excess of 2% of the city's 1972 payable 1973 levy limit base per capita, the city is entitled to a special levy pursuant to Section 275.50, Subdivision 5(n) for levy year 1973, taxes payable in 1974. The city may, therefore, levy up to $20,000 as a special levy to compensate for certain decreased non-tax revenues.

Rev LL 21 Compensation for Decreased Mobile Homes Property Tax Receipts. A levy to compensate for a decrease in mobile homes property tax receipts is a special levy to the extent that the governmental subdivision's portion of the actual total levy in the current levy year, pursuant to Minnesota Statutes, Section 273.13, Subdivision 3, as amended, is less than the distribution of mobile homes tax the governmental subdivision was entitled to receive pursuant to Minnesota Statutes, Section 273.13, Subdivision 3, in calendar year 1971.

Example. A governmental subdivision was entitled to receive a mobile homes tax distribution of $10,000 in calendar year 1971. In levy year 1972, taxes payable in 1973, the governmental subdivision levied 15 mills on all taxable property excluding mobile homes. Pursuant to Minnesota Statutes, Section 273.13, Subdivision 3, the mobile homes property tax for the governmental subdivision in levy year 1973 and payable in 1973, is based on the governmental subdivision's rate of levy in the preceding levy year applied to the 1973 taxable value of mobile homes located within the governmental

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subdivision's territory. Since the 1973 taxable value of mobile homes within the governmental subdivision is $600,000, the mobile homes property tax levied and collected by the governmental subdivision in 1973 is $600,000 times 15 mills or $9,000. This is a decrease of $1,000 from the calendar year 1971 mobile homes tax which the governmental subdivision was entitled to receive. Therefore, the governmental subdivision may levy $1,000 as a special levy in levy year 1973, taxes payable in 1974, to compensate for a decrease in mobile homes property tax receipts.

Rev LL 22 Compensation for Decreased Gross Earnings Tax Aids. A levy to compensate for a decrease in gross earnings tax aids pursuant to Minnesota Statutes, Sections 276.15 to 276.18; 368.39 to 368.42; or 373.20 to 373.24 is a special levy to the extent that the distribution of these aids to which the governmental subdivision was entitled to receive in the calendar year immediately preceding the current levy year is less than the distribution of these aids to which the governmental subdivision was entitled to receive in calendar year 1971.

Laws of Minnesota 1973, Chapter 650, Article XXVII abolished these aids for all payments required to be made thereunder subsequent to December 31, 1973. The last payment that a governmental subdivision will be entitled to receive will be for calendar year 1973 (whether actually paid in calendar year 1973 or in calendar year 1974). This means that for levy year 1975 and thereafter, taxes payable in 1976 and thereafter, a governmental subdivision may levy as a special levy an amount equal to the entire amount of gross earnings tax aids it was entitled to receive in calendar year 1971 pursuant to Minnesota Statutes, Sections 276.15 to 276.18; 368.39 to 368.42; or 373.20 to 373.24.

Example. A village was entitled to receive $20,000 in gross earnings tax aids for calendar year 1971 pursuant to Minnesota Statutes, Sections 276.15 to 276.18. For calendar year 1973 the village was entitled to $18,000 in gross earnings tax aids, a decrease of $2,000 from the calendar year 1971 level. This $2,000 decrease could be compensated for by a special levy in levy year 1974, taxes payable in 1975. Due to the elimination of the village's gross earnings aids after calendar year 1973 (pursuant to Laws of Minnesota 1973, Chapter 650, Article XXVII), the village would be entitled to a $20,000 special levy in levy year 1975 and each levy year thereafter, to compensate for the elimination of its gross earnings tax aids paid pursuant to Minnesota Statutes, Sections 276.15 to 276.18.

Rev LL 23 Compensation for a County Auditor's Error of Omission. A levy to pay the amounts required, in accordance with Minnesota Statutes, Section 275.075, to correct for a county auditor's error of omission in levy year 1971 or a subsequent levy year, is a special levy to the extent that when added to the certified budget levy of the governmental subdivision in the levy year such error occurred, it is not in excess of an applicable statutory, special law or charter limitation, or the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56 in such levy year.

The term "county auditor's error of omission," for the purpose of the Levy Limitations Law, includes, but is not limited to: (1) the failure to include a part or all of a tax amount certified by the governing body of a governmental subdivision; (2) the computation of an incorrect mill rate which results in a smaller amount of property taxes being extended on the

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tax lists than was certified by the governing body of a governmental subdivision, except when the reduced tax and the reduced mill rate are the result of the county auditor reducing the certified budget levy by the 1973 reimbursement aid distributed pursuant to Minnesota Statutes 1971, Section 477A.02; and (3) the deduction, by the county auditor, of a state aid from a tax levy when such state aid had already been deducted by the State of Minnesota or the governing body of the governmental subdivision in determining its tax levy, and such deduction was not the responsibility of the county auditor. For the purposes of the Levy Limitations Law, the term "county auditor's error of omission" does not include tax amounts purposely omitted from the tax lists by the county auditor because such amounts were in excess of an applicable statutory, special law or charter limitation, or the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56.

Example 1. A village certified to the county auditor a $4,000 levy for the purpose of controlling insect pests and Dutch Elm disease. Such levy was within all applicable limitations on the per capita, mill and dollar amount of taxes the village was permitted to levy, and this amount should have been spread on the tax lists for taxes payable in 1972. However, the county auditor failed to extend the levy on the appropriate tax lists. In levy year 1972, taxes payable in 1973, no amount was levied to correct for the county auditor's error of omission. In levy year 1973, taxes payable in 1974, the village would be entitled to a special levy of $4,000 to compensate for the county auditor's error of omission in levy year 1971, taxes payable in 1972.

Example 2. A city certified a total levy of $10,000,000 to the county auditor for levy year 1972, taxes payable in 1973, from which the county auditor was to deduct $150,000 in reimbursement aid to be paid in 1973 pursuant to Minnesota Statutes 1971, Section 477A.02. In determining the mill rates for the city, however, a taxable value of $549,720,000 was used instead of the actual taxable value of $548,860,000. This error was due to the double counting of a manufacturing plant with a taxable value of $860,000. The result for the $9,850,000 spread levy was a computed mill rate of 17.919 instead of the correct mill rate of 17.947. In the process of spreading the taxes on the tax lists, the double counting error was discovered. Due to this county auditor's error of omission, the city had a spread levy amount of $9,835,022 instead of the correct amount of $9,850,000. The difference of $14,978 could be compensated for by a special levy in that amount in levy year 1973, taxes payable in 1974.

Example 3. In levy year 1973, taxes payable in 1974, the Department of Revenue certified a 1973 payable 1974 levy limitation (pursuant to Sections 275.50 to 275.56) of $150,000 to Village of the North. This amount was after deduction of $45,000 in Local Government Aid and $500 of Attached Machinery Aid to be paid in calendar year 1974. Village of the North voted a tax levy of $150,000 plus $30,000 of special levies for a total levy of $180,000 and certified this levy to the county auditor. However, the county auditor deducted the $45,000 Local Government Aid once again and spread only $135,000 on the tax lists. Because of this county auditor's error of omission, Village of the North would be entitled to a special levy of $45,000 in levy year 1974, taxes payable in 1975, as compensation for such error.

A county auditor's error of omission in levy year 1970, taxes payable in 1971 cannot be compensated for by a "special levy" since it is a permanent

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adjustment to the governmental subdivision's levy limit base per capita for levy year 1973 and levy years thereafter. (See Rev LL 31 for adjustments to levy limit bases per capita to compensate for errors of omission in levy year 1970, taxes payable in 1971.)

Rev LL 24 Compensation for an Error of Omission in the Levy Certified to the County Auditor. A levy to compensate for an error of omission in the levy certified to the appropriate county auditor or auditors by the governing body of a city, village, borough or town with village powers in levy year 1971 or a subsequent levy year is a special levy to the extent that when added to the certified budget levy of the governmental subdivision in the levy year such error occurred, it is not in excess of an applicable statutory, special law or charter limitation, or the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56 in such levy year.

For the purpose of the Levy Limitations Law, these errors of omission include, but are not limited to:

(1) failure to certify to the county auditor a tax which was voted by the governing body of the governmental subdivision; (2) inadvertently certifying a lesser tax levy than the tax levy voted by the governing body of the governmental subdivision; and (3) deducting a state aid from a tax levy when such deduction is the responsibility of the county auditor and the county auditor subsequently reduces the tax levy further by the amount of the state aid.

For the purpose of the Levy Limitations Law, these errors of omission do not include tax amounts which were not voted by the governing body of the governmental subdivision. Also, these errors of omission do not include tax amounts voted by the governing body of the governmental subdivision which were purposely not certified to the county auditor because such amounts were in excess of an applicable statutory, special law, or charter limitation, or the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56.

Example 1. In levy year 1972, taxes payable in 1973, the clerk of a village failed to certify the tax levy voted by the village council to the county auditor. In levy year 1973, taxes payable in 1974, the village could levy a "special levy" in the amount of the omitted levy to compensate for the error.

Example 2. In levy year 1972, taxes payable in 1973, the council of a city voted a tax levy of $200,000. From this amount the city clerk deducted $15,000 of reimbursement aid to be paid to the city in 1973 pursuant to Minnesota Statutes 1971, Section 477A.02. The amount certified to the county auditor was then $185,000. The county auditor, unaware of what the city clerk had done, deducted the $15,000 reimbursement aid from the certified budget levy of $185,000, as was his duty pursuant to Minnesota Statutes 1971, Section 477A.02 (c). The reduced amount of $170,000 was then spread on the tax lists. Due to the city clerk's error, the city would be entitled to levy a $15,000 special levy in levy year 1973, taxes payable in 1974 to compensate for such error.

Example 3. Village A has a levy limitation of $25,000 pursuant to the Levy Limitations Law for levy year 1973, taxes payable in 1974. The village wants to levy $25,000 plus special levies and in addition wants to levy $2,000 for advertising. However, the $2,000 levy for advertising does not qualify

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as a special levy and would be in excess of the village's levy limitation when added to the $25,000 levy subject to the limitation. In looking at the village's 1972 payable 1973 levy, it was discovered that the village had certified a tax levy of $21,500 (in addition to special levies), which was $2,100 below the 1972 payable 1973 levy limitation of $23,600. Since no amount was levied for advertising in levy year 1972 payable 1973, and since the village levied $2,100 below its levy limitation in levy year 1972 payable 1973, the village council wanted to claim a $2,000 "special levy" in levy year 1973 payable 1974 as compensation for an error of omission in the levy certified to the county auditor in levy year 1972 payable in 1973. However, this levy would not qualify as a "special levy" under the Levy Limitations Law.

An error of omission by the governing body of a city, village, borough or town with village powers in levy year 1970, taxes payable in 1971 cannot be compensated for by a "special levy" since it is a permanent adjustment to the governmental subdivision's levy limit base per capita for levy year 1973 and levy years thereafter. (See Rev LL 31 for adjustments to levy limit bases per capita to compensate for errors of omission in levy year 1970, taxes payable in 1971.)

Rev LL 25 Increased Costs Resulting From Minnesota Municipal Commission Orders. A levy to pay the increased costs of municipal services as the result of an annexation or consolidation ordered by the Minnesota Municipal Commission in levy year 1971 or a subsequent levy year is a special levy but only to the extent and for the levy years provided by the Commission in its order pursuant to Minnesota Statutes, Section 414.01, Subdivision 15.

This special levy relates to Minnesota Municipal Commission orders which enlarge an existing municipality or create a new municipality. In each case the Commission is charged with the responsibility of determining the increased costs of municipal services associated with extending such services to newly acquired territory or developing such services in a newly created municipality. This special levy does not relate in any way to annexations by ordinance but is confined entirely to annexations and consolidations which are ordered by the Minnesota Municipal Commission pursuant to Minnesota Statutes, Chapter 414.

The special levy pursuant to Section 275.50, Subdivision 5 (s) is retroactive to Minnesota Municipal Commission orders in levy years 1971 and 1972. This means that the Minnesota Municipal Commision will estimate the increased costs of municipal services due to Commission orders issued in levy years 1971 and 1972. Provided that a revised order is issued, a municipality entitled to special levies for the increased costs of municipal services due to a Commission order issued in levy year 1971 or 1972 will be allowed in levy year 1973, taxes payable in 1974, a special levy to compensate for the computed "special levies" for such prior years, in addition to the computed special levy for levy year 1973, subject to the years for which the municipality is allowed a special levy by the Minnesota Municipal Commission in its revised order.

For the purpose of the Levy Limitations Law, the special levy for an enlarged municipality shall be the yearly increased costs of municipal services as estimated by the Minnesota Municipal Commission pursuant to Minnesota Statutes, Section 414.01, Subdivision 15, minus: (1) an amount equal to the acquiring municipality's current levy year's levy limit base per capita in the year of annexation multiplied times the population of the annexed territory as contained in the Minnesota Municipal Commission's order, and

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(2) the increased costs of municipal services extended to the annexed territory paid for through special assessments or through bonded indebtedness or any other "special levy" pursuant to Section 275.50, Subdivision 5, other than the "special levy" pursuant to Section 275.50, Subdivision 5 (s).

Example. City W annexed a portion of Township Z, a town without village powers, following a Minnesota Municipal Commission order issued in levy year 1971. According to the Commission order, the population of the annexed territory was 450 persons. This number multiplied times the city's 1971 payable 1972 levy limit base per capita of $38.00 increased the city's 1971 payable 1972 levy limit base by $17,100. In levy year 1973, pursuant to Minnesota Statutes, Section 414.01, Subdivision 15, the Minnesota Municipal Commission revised its order to City W to estimate the increased cost of municipal services due to such order. The increased cost of these municipal services for the purpose of Section 275.50, Subdivision 5 (s) was found to be $25,000 per year for the levy years 1971 through 1975. Since $3,000 of the increased yearly costs of municipal services were being paid for through bonded indebtedness and special assessments, the special levy for levy years 1971, 1972 and 1973 would be $4,900 each year ($25,000 — $17,100 — $3,000 = $4,900). Therefore, in levy year 1973, taxes payable in 1974, City W would be entitled to a special levy of $14,700 (for levy years 1971-1973) to pay the increased costs of municipal services due to a Minnesota Municipal Commission order.

For the purpose of the Levy Limitations Law, the special levy for a newly created municipality shall be the yearly costs of municipal services as estimated by the Minnesota Municipal Commission pursuant to Minnesota Statutes, Section 414.01, Subdivision 15, minus: (1) an amount equal to the current levy year's levy limit base per capita for the newly formed municipality in the year of consolidation (see Rev LL 42 for the determination of levy limitations for newly created municipalities) multiplied times the population of the newly created municipality as contained in the Minnesota Municipal Commission's order, and (2) the increased costs of municipal services for the newly created municipality paid for through special assessments or through bonded inedebtedness or any other "special levy" pursuant to Section 275.50, Subdivision 5, other than the "special levy" pursuant to Section 275.50, Subdivision 5 (s).

Example. In levy year 1973, the Minnesota Municipal Commission ordered the consolidation of Township J into an entirely new village, Village J. The estimated total cost of all municipal services, including increased costs due to the Commission's order, was determined by the Commission to be $100,000 in levy year 1973 decreased by $5,000 in each of the next four levy years. The population of Village J as contained in the Commission's order was 1,100. This amount multiplied times the new village's 1973 payable 1974 levy limit base per capita of $34.00 (see Rev LL 42 for the determination of levy limitations for newly created municipalities) produced a 1973 payable 1974 levy limit base of $37,400. Since none of the increased costs of municipal services will be paid for through bonded indebtedness or special assessments in levy year 1973 payable 1974, the special levy for levy year 1973 payable 1974 would be $62,600 ($100,000 — $37,400).

Rev LL 26 Increased Costs Resulting From Extending Municipal Services to New Private Industrial and Nonresidential Commercial Development. Subject to the limitations of Section 275.50, Subdivision 5 (t), a levy to pay

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the increased costs resulting from extending municipal services to new private industrial and nonresidential commercial development is a special levy insofar as the extension of such services are not paid by bonded indebtedness, special assessments, or user service charges, or any "special levy" pursuant to Section 275.50, Subdivision 5, other than the special levy pursuant to Section 275.50, Subdivision 5 (t). For the purpose of determining the special levy pursuant to Section 275.50, Subdivision 5 (t), the term "development" means the construction of totally new structures or buildings and the enlarging of previously existing structures or buildings, but does not include internal alterations and improvements of previously existing structures or buildings.

This special levy shall be calculated separately for each new private industrial or nonresidential commercial development. For the purpose of the Levy Limitations Law, there is a separate and distinct "new private industrial or nonresidential commercial development" associated with each building permit issued, in calendar year 1970 or calendar years thereafter, for the purpose of such private industrial or nonresidential commercial construction as included in the term "development" defined in the preceding paragraph. After the special levy for each new private industrial or nonresidential commercial development has been calculated, the governmental subdivision may aggregate them to derive one total amount.

Included in the special levy pursuant to Section 275.50, Subdivision 5 (t) is the increased expenditures, commonly called "front money" or "site preparation costs," necessary in preparation for the delivering of municipal services to a new private industrial and nonresidential commercial development. These are primarily construction costs, such as the costs of building roads out to the development or extending water and sewer lines to it. For each separate new private industrial or nonresidential commercial development, only one year's expenditures (the expenditures for 365 days or one calendar year, at the choice of the governmental subdivision) necessary in preparation for the delivering of municipal services may be included in the special levy pursuant to Section 275.50, Subdivision 5 (t), and in only one levy year. The one year's site preparation costs for a private industrial or nonresidential commercial development may be levied in only one levy year, except that such costs may be apportioned between two levy years, so that a portion of the costs is levied in each of the two selected levy years. Only expenses actually incurred after December 31, 1972, may be used in determining this inclusion in the special levy pursuant to Section 275.50, Subdivision 5 (t). This may include expenses incurred prior to the issuance of the building permit as well as expenditures made subsequent to the issuance of the building permit. Estimated future site preparation costs may not be included in determining the special levy pursuant to Section 275.50, Subdivision 5 (t).

Also included in the special levy pursuant to Section 275.50, Subdivision 5 (t) is an allowance for the increased costs of police and fire protection, the increased costs of maintaining new roads, water and sewer lines, and the increased costs of other municipal services extended to a new private industrial and nonresidential commercial development. This amount is calculated by applying a mill rate times the increased assessed value of the new private industrial or nonresidential commercial development located within the governmental subdivision. The mill rate is the overall levy limitation of the governmental subdivision for the current levy year, established pursuant to Sections 275.50 to 275.56, divided by the total taxable value

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of the governmental subdivision for the current levy year. The increase in assessed value of the new private industrial or nonresidential commercial development is calculated as the increase in assessed value for the current levy year (after levy year 1972, taxes payable in 1973) over the assessed value of the real estate parcels within the governmental subdivision subject to such private development as most recently determined before the building permit was issued. The term "real estate parcels" as used here includes buildings and structures as well as the land. For the purpose of Section 275.50, Subdivision 5 (t), the assessed value of property for an assessment year prior to assessment year 1972 shall be an amount equal to the assessor's value for the property in such prior year multiplied times 3. In the fourth levy year subsequent to the levy year in which the building permit was issued, the governmental subdivision shall no longer be entitled to a special levy for the increased costs of providing municipal services to that particular private industrial or nonresidential commercial development.

The aggregate of the foregoing amounts, less any portion paid or to be paid by bonded indebtedness or special assessments, or by user service charges imposed on the developer of the industrial or nonresidential commercial development equals the maximum amount that a governmental subdivision may levy as a "special levy" pursuant to Section 275.50, Subdivision 5 (t).

Example 1. A city issued a building permit in 1973 for a new industrial plant. The city subsequently widened the road out to the industrial plant, installed traffic signals, and ran sewer and water lines to the construction site. The costs of these improvements to the city totaled $40,000 in calendar year 1973. Of this amount, $30,000 was being paid for by bonds and special assessments. The remaining $10,000 would qualify as a "special levy" for one levy year only, or could be apportioned between two levy years.

Example 2. A large discount department store was built subsequent to the city issuing its permit in April of 1970. The January 2, 1970 assessed value of the parcels subject to this development, multiplied by 3, was $60,000. In levy year 1973, the first and last levy year that the city may claim a special levy for the cost of extending municipal services to this particular development, the assessed value of the property is $1,000,000, a $940,000 increase. The 1973 payable 1974 levy limitation for the governmental subdivision, established pursuant to Sections 275.50 to 275.56, is $300,000. The total taxable value of the governmental subdivision, including the $1,000,000 assessed value of the discount department store, for taxes levied in 1973, is $20,000,000. The levy limitation of $300,000 divided by the total taxable value of $20,000,000 equals a mill rate of 15 mills. This mill rate multiplied times the $940,000 increase in assessed value of the discount department store equals $14,100, the amount which the governmental subdivision can levy in 1973 as a special levy to pay the increased costs of providing municipal services to this particular new discount department store.

Rev LL 27 Other Levies Outside of the Overall Levy Limitations. In addition to the special levies provided in Section 275.50, Subdivision 5, certain other levies may be levied outside a governmental subdivision's overall levy limitation without being subject to the penalty provisions of Section 275.51, Subdivision 4. These are levies which are authorized in excess of the levy limitations pursuant to Sections 275.50 to 275.56 by laws of the 1971 or subsequent years' legislatures. The entire amount levied for any of the

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following purposes is outside the levy limitations pursuant to Sections 275.50 to 275.56:

(a) A levy pursuant to Minnesota Statutes, Section 275.57, for the removal of property condemned as hazardous to health, safety or welfare;

(b) A levy by either the City of Mankato or the City of North Mankato, pursuant to Laws of Minnesota 1973, Chapter 81, in an amount not to exceed one-tenth of one mill, to provide funds for musical entertainment;

(c) A levy by a governmental subdivision, pursuant to Laws of Minnesota 1973, Chapter 160, Section 10, Subdivision 3, to pay the costs charged to it by the Dover, Eyota and St. Charles Area Sanitary District;

(d) A levy by a city or village, pursuant to Laws of Minnesota 1973, Chapter 322, Section 1, to provide for the payment of all special assessments and other charges imposed upon the area of such city or village served by a public water or sewer system established pursuant to Minnesota Statutes, Sections 116A.01 to 116A.26;

(e) A levy by the City of Brainerd pursuant to Laws of Minnesota 1973, Chapter 445, in an amount not to exceed 2 mills on taxable value, $3 per capita or $15,000, whichever is less, for the purpose of supporting a program of public recreation and playgrounds or other recreational facilities;

(f) A levy by the City of St. Paul, pursuant to Laws of Minnesota 1973, Chapter 719, Section 3, to repay the amount which was borrowed (not to exceed $300,000) in calendar year 1973 for the support of social service programs.

Rev LL 28 Imposition of Levy Limitations. Section 275.51, Subdivision 1 provides that the levies of governmental subdivisions for levy years 1971, 1972 and subsequent levy years, for all purposes except special levies and special assessments, shall be subject to the levy limits determined in accordance with the procedures set forth in Section 275.51. Subject to Section 275.56, the levy limits determined pursuant to Section 275.51 supersede all provisions of law or municipal charter to the contrary (except laws of the 1973 legislature or a subsequent year's legislature which expressly exempt levies from the limitations imposed by Sections 275.50 to 275.56) which would otherwise authorize ad valorem levies in excess of the limitations established by Sections 275.50 to 275.56.

Rev LL 29 Calculation of the 1971 Payable 1972 Levy Limitations. The property tax levy limitation for each governmental subdivision in 1971 for taxes payable in 1972 is calculated as follows:

(a) The first step is to take the total amount of ad valorem taxes actually levied by the governmental subdivision in 1970 for taxes payable in 1971. This is not the amount certified to the county auditor but is the actual amount that was spread by him on taxable value before any reduction prescribed by Sections 273.13 and 273.135 in respect to homestead property. Special assessments on benefited property are excluded from this amount. Levies for any of the special taxing districts enumerated in Rev LL 3 of these rules and regulations are excluded from the governmental subdivision's levy. Levies for another taxing district (including county school tuition and transportation levies) are excluded from the governmental subdivision's levy.

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Levies for functions of the governmental subdivision (including county library levies and other taxing district levies that do not encompass the entire taxing district) which were levied separately are included in the governmental subdivision's levy.

Example 1. The ad valorem levy of a housing and redevelopment authority was included in the ad valorem levy of a city in a 1971 Abstract of Tax Lists. This housing and redevelopment authority is not a board, department or function of the city governmental subdivision. It is one of the special taxing districts listed in Rev LL 3 of these rules and regulations. Therefore, the levy by and for the housing and redevelopment authority shall be excluded from the levy of the city as reported in the 1971 Abstract of Tax Lists.

Example 2. The ad valorem levy by a township on the taxable valuation of a contiguous village was included in the ad valorem levy of the village in a 1971 Abstract of Tax Lists. The purpose of such a levy is to finance the cost of services provided by the township to the village (such as snow removal, town dump or voting facilities). Since this levy was by and for the township, it shall be excluded from the levy of the village (as reported in the 1971 Abstract of Tax Lists) and included in the levy of the township (as reported in the 1971 Abstract of Tax Lists).

Example 3. A township ad valorem levy for a special fire protection district within the township was shown separately as a special district levy in a 1971 Abstract of Tax Lists. This levy, though not a township-wide levy, is a levy by the township for services arranged by the township for the benefit of the special fire protection district. The special fire protection district is not a governmental subdivision and is not a special taxing district. Therefore, the levy for the special fire protection district shall be included in the levy (as shown on the 1971 Abstract of Tax Lists) of the township which levied such tax.

If the governmental subdivision levied such taxes in 1970, taxes payable in 1971, for a period shorter than 12 months, then such taxes levied in the most recent preceding year for a period of 12 months shall be used for this calculation. This applies only to those situations where a governmental subdivision switched from a fiscal to a calendar budget year for taxes levied in 1970 and payable in 1971.

Example. A city handled its finances on a July 1 to June 30 fiscal year basis for levy year 1969, at which time it levied for fiscal year July 1, 1970 to June 30, 1971. In levy year 1970 the city switched to a calendar year financial basis. Since the city had previously levied for the first half of calendar year 1971, the city levied in 1970 for just the last six months of calendar year 1971. For levy limitation purposes, the taxes levied in 1969 for the fiscal year July 1, 1970 to June 30, 1971, would be used.

(b) The next step is to deduct those portions of the taxes levied in part (a) which are "special levies". These are just the items which would be special levies by applying the definitions of "special levy" in Section 275.50, Subdivision 5 to the 1970 levy, taxes payable in 1971. By such application, the only items which would be "special levies" are the levies for welfare and bonded indebtedness. The other "special levies" pursuant to Section 275.50, Subdivision 5 do not apply to this deduction since they are all related to increases over the payable 1971 level.

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For the purpose of this regulation, a levy for "welfare" includes:

(1) A levy for the administrative costs of categorical welfare aids and poor relief and the costs of administration of social services and the purchase of social services. (See Rev LL 13 for matching fund levies); and

(2) A levy to pay the costs of actual aid payments to recipients under the categorical welfare aids and poor relief programs. (See Rev LL 15 for the special levy for cash public assistance programs.)

For the purpose of this regulation, a levy for "bonded indebtedness" includes:

(1) A levy to pay the principal and interest on bonded indebtedness. (See Rev LL 16 for bonded indebtedness special levies);

(2) A levy to pay the principal and interest on certificates of indebtedness, except tax anticipation or aid anticipation certificates of indebtedness, issued for any corporate purpose except to pay current expenses or to fund an insufficiency in receipts from taxes or other sources or to fund extraordinary expenditures resulting from a public emergency. (See Rev LL 17 for the special levy for certificates of indebtedness);

(3) A levy to fund the payments made to the Minnesota State Armory Building Commission pursuant to Minnesota Statutes, Section 193.145, Subdivision 2, to retire the principal and interest on armory construction bonds. (See Rev LL 18 for the special levy for armory construction bonds); and

(4) A levy to provide for the bonded indebtedness portion of payments made to another political subdivision of the State of Minnesota. (See Rev LL 19 for the special levy to pay principal and interest on another governmental subdivision's bonds.)

(c) The next step is to add the Exempt Property Reimbursement (pursuant to Minnesota Statutes 1969, Section 273.69) and Sales Tax Per Capita Aid (pursuant to Minnesota Statutes 1969, Sections 297A.51 to 297A.60) that the governmental subdivision was entitled to receive in calendar year 1971, minus the allocation of these aids on a percentage distribution basis to the welfare and bonded indebtedness special levies in taxes payable year 1971. These aids are the payable 1971 tax year amounts estimated by the Department of Revenue and may not necessarily be the amounts that were actually received by the governmental subdivision in 1971. The aid amounts estimated by the Department of Revenue are the amounts that the governmental subdivision should have received in 1971 without regard for adjustments to previous years' payments. For the purpose of this regulation, the terms "welfare" and "bonded indebtedness" have the meanings given them in (b) above.

(1) The 1971 Exempt Property Reimbursement amount added to the ad valorem levy of part (a) above is the total amount paid as estimated by the Department of Revenue minus the following allocation:

$$\frac{\text{Welfare and bonded indebtedness special levies from part (b)}}{\text{Total 1970 ad valorem levy payable in 1971 from part (a)}} \times \text{Total 1971 estimated governmental subdivision's Exempt Property Reimbursement}$$

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(2) The 1971 Sales Tax Per Capita Aid amount added to the ad valorem levy of part (a) is the amount estimated by the Department of Revenue minus the following allocation:

$$\frac{\text{Welfare special levy from part (b)}}{\text{Total 1970 ad valorem levy payable in 1971 from part (a)}} \times \text{Total 1971 estimated governmental subdivision's Sales Tax Per Capita Aid}$$

(d) The total 1970 ad valorem levy payable in 1971 of part (a) minus the special levies of part (b) plus the Exempt Property Reimbursement and Sales Tax Per Capita Aid of part (c) of the governmental subdivision is divided by the 1970 population of the governmental subdivision pursuant to Section 275.53 in order to derive the 1970 payable 1971 levy limit base per capita. (See Rev LL 40 for determination of population and Rev LL 41 for governing population census or estimate.) The 1970 Federal census figures (corrected final figures) are used for this step since none of the other methods of determining population authorized by Section 275.53 are applicable to 1970.

(e) The 1970 payable 1971 levy limit base per capita determined in part (d) is then multiplied by the annual 6% increase in accordance with Section 275.52, Subdivision 2 in order to derive the levy year 1971 payable 1972 levy limit base per capita increase. (See Rev LL 38 for the annual 6% increase.)

(f) The levy year 1971 payable 1972 levy limit base per capita increase is added to the 1970 payable 1971 levy limit base per capita to derive the 1971 payable 1972 levy limit base per capita.

(g) The 1971 payable 1972 levy limit base per capita is then multiplied by the most recent 1971 population figure to produce the total 1971 payable 1972 levy limit base for the governmental subdivision. The population figure used is the 1970 Federal census figure, or for the seven county metropolitan area, estimates by the Metropolitan Council, unless a different population for the governmental subdivision was established by one of the allowable methods pursuant to Section 275.53, and such population was governing for the purpose of the Levy Limitations Law.

(h) Next, the 1972 amounts of the aids to local units of government enacted by the 1971 legislature are deducted from the governmental subdivision's total 1971 payable 1972 levy limit base.

(1) The Local Government Aid due and payable to the governmental subdivision in 1972, as determined by the Department of Revenue pursuant to Minnesota Statutes, Section 477A.01, is deducted. For most governmental subdivisions, this is the only aid deducted.

(2) Certain municipalities in the iron range counties qualify for Taconite Municipal Aid. The amount of this aid, as determined by the Department of Revenue pursuant to Minnesota Statutes, Section 298.282, is deducted from the 1971 payable 1972 levy limit base of the qualifying municipalities.

(i) The 1971 payable 1972 levy limit base of the governmental subdivision minus its 1972 amount of the aforementioned aids of part (h) is the 1971 payable 1972 overall levy limitation for the governmental subdivision, exclusive of special levies and special assessments. The governmental subdivision could not levy more than the sum of its overall levy limitation plus

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its special levies and special assessments without being subject to the penalty provisions of Section 275.51, Subdivision 4 and the administrative action of the Commissioner of Revenue pursuant to Section 275.55. Other statutory and charter limitations on tax levies may have prohibited the governmental subdivision from having a levy as large as its overall levy limitation established pursuant to Sections 275.50 to 275.56.

Rev LL 30 Calculation of Levy Limits in Subsequent Levy Years. The property tax levy limitation for a governmental subdivision in 1972 and subsequent levy years is calculated as follows:

(a) The governmental subdivision's levy limit base per capita for the immediately preceding levy year is increased by the annual 6% adjustment pursuant to Section 275.52, Subdivision 2. (See Rev LL 38 for the annual 6% increase.) The resulting product of this operation is the governmental subdivision's current levy year's levy limit base per capita.

(b) The current year's levy limit base per capita of part (a) is then multiplied by the current levy year's population of the governmental subdivision according to the latest Federal or state census, or an estimate as established pursuant to Section 275.53, whichever is the most recent. (See Rev LL 40 for determination of population and Rev LL 41 for governing population census or estimate.) This produces the total current year's levy limit base for the governmental subdivision.

(c) The total current year's levy limit base of part (b) is reduced by the amounts of the Local Government Aid (determined pursuant to Minnesota Statutes, Section 477A.01) and the Taconite Municipal Aid (determined pursuant to Minnesota Statutes, Section 298.282), if any, which the Department of Revenue estimates as due and payable to the governmental subdivision during the tax collection year to which the current year's levy limit base applies. These aids do not reflect any adjustments for penalties assessed pursuant to Section 275.51, Subdivision 4. (See Rev LL 35 for penalties.) Commencing with levy year 1973 and levy years thereafter, the total current year's levy limit base of part (b) is also reduced by the amount of Attached Machinery Aid which the Department of Revenue estimates as due and payable to the governmental subdivision, pursuant to Laws of Minnesota 1973, Chapter 650, Article XXIV, Section 5, during the tax collection year to which the current year's levy limit base applies. The resulting figure of this calculation is then the current year's overall levy limitation for the governmental subdivision, exclusive of special levies and special assessments. The governmental subdivision cannot levy more than the sum of its overall levy limitation plus its special levies and special assessments without being subject to the penalty provisions of Section 275.51, Subdivision 4, and the Commissioner of Revenue's administrative action pursuant to Section 275.55.

The amount actually levied by a governmental subdivision in 1971 or subsequent levy year, for all purposes except special levies and special assessments, in no way affects its levy limitation. That is, the levy limitation for 1972 or subsequent levy year is based on the previous year's levy limit base per capita and not on the previous year's actual levy for all purposes, exclusive of special levies and special assessments. If the governmental subdivision levies in excess of its overall levy limitation, such levy in no way builds up the overall levy limitation for the subsequent levy year, unless it is approved by the voters of the governmental subdivision at a general or special election pursuant to Section 275.51, Subdivision 4 or Section 275.58.

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(See Rev LL 44 for review of levy limitations, and Rev LL 36 and Rev LL 50 for adjusting levy limit bases per capita by election.)

Rev LL 31 Adjustments to the Base for Errors of Omission in Levy Year 1970, Taxes Payable in 1971. For the purpose of determining levy limitations for levy year 1973 and subsequent levy years, the following adjustment is made to a governmental subdivision's levy limit base per capita to include errors of omission committed in levy year 1970, taxes payable in 1971:

(a) The first step is to take the amount of a county auditor's error of omission in the ad valorem taxes extended in levy year 1970, taxes payable in 1971, but only to the extent that when included in the governmental subdivision's levy in 1970, taxes payable in 1971, such amount is not in excess of an applicable statutory, special law or charter limitation imposed on the governmental subdivision in levy year 1970. The term "county auditor's error of omission" has the same meaning as given to it in Rev LL 23 of these Rules and Regulations. (See Rev LL 23 for the "special levy" for a county auditor's error of omission.)

(b) The second step is to take the amount of an error of omission in the levy certified to the appropriate county auditor or auditors by the governing body of a city, village, borough or town with village powers in levy year 1970, taxes payable in 1971, but only to the extent that when included in the governmental subdivision's levy in 1970, taxes payable in 1971, such amount is not in excess of any applicable statutory, special law or charter limitation imposed on the governmental subdivision in levy year 1970. The term "error of omission" as used herein has the same meaning as given to it in Rev LL 24 of these Rules and Regulations. (See Rev LL 24 for the "special levy" for an error of omission in the levy certified to the county auditor.)

(c) The next step is to aggregate the amounts from parts (a) and (b) and increase them by 12.36 percent.

(d) The product of part (c) is divided by the 1972 population of the governmental subdivision established pursuant to Section 275.53 to derive the per capita adjustment. The 1972 population is used instead of the 1973 population since this per capita adjustment is to be added to the governmental subdivision's 1972 payable 1973 levy limit base per capita, which is calculated using the governmental subdivision's 1972 population. (See Rev LL 40 for determination of population and Rev LL 41 for governing population census or estimate.)

(e) The per capita amount calculated in part (d) is added to the governmental subdivision's 1972 payable 1973 levy limit base per capita. (See Rev LL 30 for calculation of levy limits in levy year 1972 and subsequent levy years.) This is a permanent adjustment to the governmental subdivision's levy limit base per capita and is increased yearly (as part of such levy limit base per capita) pursuant to Section 275.52, Subdivision 2 for the purpose of determining levy limitations for levy year 1973 and thereafter, taxes payable in 1973 and thereafter.

This adjustment shall not be construed to alter in any way the amount of Local Government Aid estimated by the Department of Revenue to be paid the governmental subdivision pursuant to Minnesota Statutes, Section 477A.01 in calendar years 1972 and 1973, nor shall it be construed to affect

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in any way the Local Government Aid determinations for calendar year 1974.

Rev LL 32 Adjustments to the Base for Public Improvements Required to be Financed by Ad Valorem Taxation and Which Previously Were Financed by Special Assessments. For the purpose of determining levy limitations for levy year 1973 and thereafter, a governmental subdivision shall have its levy limit base per capita adjusted for laws of the Minnesota Legislature which require that public improvements be financed by ad valorem taxation, which are of a type financed by special assessments in calendar year 1971. As used in this regulation, "public improvements" means only those types of improvements enumerated in Minnesota Statutes, Sections 429.021, Subdivision 1 and 429.101. "Laws" referred to by this regulation mean laws which make the conversion from special assessment to ad valorem taxation mandatory, but permissive laws are included in this regulation if they stipulate that the governmental subdivision cannot revert to special assessments once it chooses to finance certain public improvements by ad valorem taxation.

Whenever (after levy year 1972) a governmental subdivision, acting pursuant to a law of the Minnesota legislature, provides that certain public improvements will henceforth be financed by ad valorem taxation, the total amount of special assessments levied in the immediately preceding levy year for such improvements shall be divided by the population of the governmental subdivision in the preceding levy year (determined pursuant to Section 275.53) and added to the governmental subdivision's levy limit base per capita for such preceding levy year. (See Rev LL 40 for determination of population, Rev LL 41 for governing population census or estimate, and Rev LL 30 for calculation of levy limits in levy year 1972 and subsequent levy years.) This is a permanent adjustment to the governmental subdivision's levy limit base per capita and is increased yearly (as a part of such levy limit base per capita) pursuant to Section 275.52, Subdivision 2 for the purpose of determining levy limitations for the current and subsequent levy years.

Example. Laws of Minnesota 1973, Chapter 393, provides that the City of Minneapolis may pay the costs of maintenance of streets and street lighting by levying ad valorem taxes. The law also provides that if the City of Minneapolis acts pursuant to the authority of such law, the city shall no longer specially assess the costs of these improvements. If the City of Minneapolis acts pursuant to Laws of Minnesota 1973, Chapter 393, the total amount of special assessments levied for maintenance of streets and street lighting in the year preceding such action shall be divided by the population of the City of Minneapolis in the preceding levy year and shall be added to the city's levy limit base per capita for such preceding levy year. This would be a permanent adjustment to the City of Minneapolis' levy limit base per capita and would be increased yearly (as a part of such levy limit base per capita) pursuant to Section 275.52, Subdivision 2 for the purpose of determining levy limitations for all levy years subsequent to the last levy year that the cost of maintenance of streets and street lighting were specially assessed.

Rev LL 33 Adjusting Levy Limitations for Certain Abolished State Aids. For levy year 1973 and thereafter, taxes payable in 1974 and thereafter, the current levy year's levy limit base for the governmental subdivision (see Rev LL 30 for the calculation of levy limits in levy year 1972 and subsequent levy years) shall be increased by the following amounts:

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(a) Calendar year 1973 cigarette tax distribution aids pursuant to Minnesota Statutes 1971, Section 297.13;

(b) Calendar year 1973 liquor tax distribution aids pursuant to Minnesota Statutes 1971, Section 340.60;

(c) November 30, 1972 and May 31, 1973, bank excise tax distribution aids pursuant to Minnesota Statutes 1971, Section 290.361;

(d) Seventy percent (if a county government) or 100 percent (if a city, village or town government) of the mortgage registry tax distribution the governmental subdivision was entitled to receive in fiscal year 1973 (July 1, 1972 through June 30, 1973).

These are the amounts, as estimated by the Department of Revenue, which the governmental subdivision was entitled to receive from the state for such payment dates or periods, as the case may be, and are not necessarily the actual amounts paid. Also, these amounts do not reflect any adjustments for prior payments.

This adjustment shall not be construed to alter in any way the governmental subdivision's levy limit base per capita, and it is not subject to the yearly 6% compounded adjustment pursuant to Minnesota Statutes, Section 275.52, Subdivision 2. The foregoing addition shall be made to the governmental subdivision's current levy year's levy limit base before the deduction of the aids estimated by the Department of Revenue to be paid to the governmental subdivision pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid), as amended, during the tax collection year to which the current levy year's levy limit base applies.

Rev LL 34 Minimum Property Tax Levy Limitation. Notwithstanding the provisions of Section 275.51, Subdivision 3 (See Rev LL 30 for the calculation of levy limits in levy year 1972 and subsequent levy years), but subject to any other statute, special act or charter limitation, each governmental subdivision shall be entitled, in levy year 1973 and subsequent levy years, to a minimum property tax levy limitation equal to six percent of its state aids estimated by the Department of Revenue to be paid, pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid), to the governmental subdivision during the tax collection year to which the property tax levy limitation applies. These state aids are the same amounts that are deducted, in addition with Attached Machinery Aid (Laws of Minnesota 1973, Chapter 650, Article XXIV, Section 5), from the current levy year's levy limit base of the governmental subdivision in determining the current year's levy limitation for the governmental subdivision under the provisions of Section 275.51, Subdivision 3.

A governmental subdivision which would maximize its property tax levy limitation under this minimum allowance shall qualify for the provisions of Section 275.51, Subdivision 3a, and the provisions of Section 275.51, Subdivision 3 shall not apply to such governmental subdivision. Any year in which a governmental subdivision qualifies for the provisions of Section 275.51, Subdivision 3a shall be known as a "qualifying levy year."

In addition to the minimum property tax levy limitation, Section 275.51, Subdivision 3a also provides a means for establishing a new levy limit base

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per capita for use under the provisions of Section 275.51, Subdivision 3. The new levy limit base per capita is determined as follows:

(a) In any levy year (qualifying levy year) that a governmental subdivision qualifies for the minimum levy limitation under Section 275.50, Subdivision 3a, the state aids estimated by the Department of Revenue to be paid, pursuant to Minnesota Statutes, Sections 477A.01 and 298.282 to the governmental subdivision in the taxes payable year to which such qualifying levy year applies shall be divided by the population of the governmental subdivision in such qualifying levy year as determined pursuant to Section 275.53. (See Rev LL 40 for the determination of population and Rev LL 41 for governing population census or estimate.)

(b) The resulting quotient of part (a) shall be increased pursuant to Section 275.52, Subdivision 2 (see Rev LL 38 for the annual 6% increase) to derive the qualifying levy year's levy limit base per capita for use under the provisions of Section 275.51, Subdivision 3.

In any subsequent levy year that a governmental subdivision would maximize its property tax levy limitation under Section 275.51, Subdivision 3, using the levy limit base per capita computed under parts (a) and (b) above for the last qualifying levy year as the preceding year's levy limit base per capita for the provisions of Section 275.51, Subdivision 3, the governmental subdivision shall no longer qualify for Section 275.51, Subdivision 3a and shall resume to have its property tax levy limitation calculated pursuant to Section 275.51, Subdivision 3.

Example. A city with a 1973 population of 1,000 has a 1973 payable 1974 levy limit base of $16,000. The city's 1974 Local Government Aid will be $15,600 and its 1974 Attached Machinery Aid will be $500. This results in a zero levy limitation for levy year 1973, taxes payable in 1974 ($16,000 — $16,100 = $(100) = 0). However, under Section 275.51, Subdivision 3a, the city is entitled in levy year 1973 to a minimum property tax levy limitation equal to 6% of its 1974 aids estimated by the Department of Revenue to be paid pursuant to Minnesota Statutes, Sections 477A.01 and 298.282. Since the city will not receive any Taconite Municipal Aid, its 1973 payable 1974 minimum levy limitation is 6% of $15,600 or $936.

In levy year 1974 payable 1975, the city still has a population of 1,000 and its 1974 payable 1975 levy limit base (pursuant to Section 275.51, Subdivision 3) is $16,960. Its 1975 Local Government Aid will be $15,700 and its 1974 Attached Machinery Aid will be $500. This results in a levy limitation of $460 pursuant to Subdivision 3. The city's minimum property tax levy limitation for levy year 1974 is 6% of $15,700 or $942. However, the city now would benefit more by resuming to have its levy limitation computed under Subdivision 3, using the preceding qualifying levy year's levy limit base per capita established under the provisions of Subdivision 3a. Under Subdivision 3a, the city's 1974 Local Government Aid of $15,600 is divided by the city's 1973 population of 1,000. The resulting per capita amount ($15.60) is increased by 6%, which produces a levy limit base per capita of $16.54 for the 1973 payable 1974 qualifying levy year under the minimum levy limitation provisions of Subdivision 3a. This per capita amount of $16.54 becomes the preceding year's levy limit base per capita for the provisions of Subdivision 3. Under Subdivision 3, the per capita amount of $16.54 would be increased by 6% pursuant to Section 275.52, Subdivision 2. The resulting current levy year's levy limit base per capita of $17.53 would then be multiplied by the city's 1974 population of 1,000 to

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derive the city's current levy year's levy limit base for 1974. The city's current levy year's levy limit base of $17,530 for levy year 1974, minus its 1975 Local Government Aid of $15,700 equals $1,830. Since this amount is greater than the city's minimum levy limitation of $942, the city would be entitled to a 1974 payable 1975 property tax levy limitation of $1,830 and would continue to have its levy limitation determined under Subdivision 3, until such time that it qualifies again for the minimum levy limitation provisions of Subdiivsion 3a.

Rev LL 35 Penalties. Pursuant to Section 275.51, Subdivision 4, penalties shall be imposed on any levy of a governmental subdivision, exclusive of special levies and special assessments, which is in excess of the governmental subdivision's overall levy limitation established pursuant to Sections 275.50 to 275.56, unless other remedy is agreed to under the provisions of Section 275.55. (See Rev LL 45 for the Commissioner's administrative action.) Penalties shall not be imposed under Section 275.51, Subdivision 4 for an actual levy in excess of the overall levy limitation if the excess is caused by the rounding of the mill rates of the governmental subdivision in accordance with Minnesota Statutes, Section 275.28.

If a governmental subdivision levies a tax in 1971 payable in 1972 for all purposes except special levies and special assessments, which is in excess of its 1971 payable 1972 overall levy limitation, the Local Government Aid and Taconite Municipal Aid distributions due and payable to such governmental subdivision in calendar year 1972 or subsequent calendar years pursuant to Minnesota Statutes, Sections 477A.01 and 298.282 shall be, pursuant to Section 275.51, Subdivision 4, reduced 10 cents for each full dollar that such levy exceeds the overall levy limitation, unless other remedy is agreed to under the provisions of Section 275.55.

If a governmental subdivision levies a tax in 1972, for all purposes except special levies and special assessments, which is in excess of its 1972 overall levy limitation, the Local Government Aid and Taconite Municipal Aid distributions due and payable to such governmental subdivision in calendar year 1973 or subsequent calendar years pursuant to Sections 477A.01 and 298.282, shall be, pursuant to Section 275.51, Subdivision 4, reduced 10 cents for each full dollar that such levy exceeds the overall levy limitation by up to five percent, and 33 cents for each full dollar that such levy exceeds the overall levy limitation by more than five percent, unless other remedy is agreed to under the provisions of Section 275.55.

If a governmental subdivision levies a tax in 1973 or a subsequent levy year, for all purposes except special levies and special assessments, which is in excess of its overall levy limitation in levy year 1973 or such subsequent levy year, the Local Government Aid and Taconite Municipal Aid distributions due and payable to such governmental subdivision in calendar year 1974 or subsequent calendar years pursuant to Sections 477A.01 and 298.282 shall be, pursuant to Section 275.51, Subdivision 4, reduced 33 cents for each full dollar that such levy exceeds the overall levy limitation, unless other remedy is agreed to under the provisions of Section 275.55.

For the purpose of determining whether or not a levy limitation has been exceeded, the levy of a metropolitan county government shall be the levy of such county before the reduction of its road and bridge fund levy as required pursuant to Minnesota Statutes, Section 163.051, Subdivision 5.

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Rev LL 36 Resolutions and Elections to Increase Levy. A governmental subdivision may determine to levy in excess of its overall levy limitation established by Sections 275.50 to 275.56, in an amount not to exceed 5 percent of such limitation and be subject to a penalty of 15 cents on each dollar of excess levy instead of the penalty of 33 cents on each dollar of excess levy as otherwise provided in Section 275.51, Subdivision 4.

In order to qualify for the reduced penalty, the governmental subdivision must pass a resolution stating the amount by which the levy limit is proposed to be exceeded. Such resolution shall be published for two consecutive weeks in the official newspaper of the governmental subdivision or if there be no official newspaper, then in a newspaper of general circulation therein. With such published resolution there shall be joined a notice announcing the date for a public hearing on the proposed increase in levy. Such hearing shall be held not less than two weeks nor more than four weeks after the first publication of the resolution and notice of hearing. Following the public hearing, the governing body of the governmental subdivision may choose to adopt a resolution authorizing the levy as originally proposed, adopt a resolution authorizing a lesser amount of excess levy, or the governing body may choose to take no further action. A resolution authorizing a levy in excess of the limitation imposed by Sections 275.50 to 275.56 shall be published in the official newspaper of the governmental subdivision, or if there be no official newspaper, such resolution shall be published in a newspaper of general circulation.

If within 30 days after the publication of the resolution authorizing the excess levy, no referendum is requested by the voters of the governmental subdivision, and if the resultion was adopted prior to October 1 in any levy year, the excess levy authorized by the resolution may be levied in that same levy year. In addition, the Local Government Aid distributions and Taconite Municipal Aid distributions due and payable to such governmental subdivision in subsequent calendar years pursuant to Minnesota Statutes, Sections 477A.01 and 298.282 shall be reduced 15 cents for each full dollar that the levy exceeds the limitation by up to five percent, and 33 cents for each full dollar that such levy exceeds the limitation by more than five percent. A levy authorized by a resolution adopted after September 30 in a given year shall not be levied in that same levy year except as subject to a penalty of 33 cents for each full dollar that such levy exceeds the limitation, unless other remedy is agreed to under the provisions of Section 275.55. However, an excess levy authorized by resolution adopted after September 30 in a given levy year may be levied in the next subsequent levy year, subject to the penalty of 15 cents for each full dollar of excess levy.

If within 30 days after the publication of the resolution authorizing the excess levy, a petition signed by voters of the governmental subdivision equal in number to five percent of the votes cast in the governmental subdivision in the last general election or 2,000 voters, whichever is less, requesting a referendum on the proposed excess levy is filed with the clerk or recorder (if the governmental subdivision is a city, village, borough or town) or the county auditor (if the governmental subdivision is county government), the resolution shall not be effective until it has been submitted to the voters at a general or special election and a majority of the votes cast on the question of approving the resolution are in the affirmative.

A levy increase approved by any such referendum at a general or special election held prior to October 1 in any levy year increases the allowable levy

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in that same levy year, without penalty, and provides a permanent adjustment to the levy limit base per capita of the governmental subdivision for future levy years. A levy increase approved by any such referendum at a general or special election held after September 30 in a given levy year shall not be levied in that same levy year, except with a 33 percent penalty, but shall provide a permanent adjustment to the levy limit base per capita for future levy years without penalty.

A levy increase approved by the voters of the governmental subdivision at a general or special election shall become a permanent adjustment to the governmental subdivision's levy limit base per capita as follows. In the first levy year subsequent to the year in which the levy increase is approved by referendum, the amount of the approved increase is divided by the population of the governmental subdivision in the year such election was held (as established pursuant to Section 275.53). This per capita amount is then added to the current year's levy limit base per capita for the year in which such election was held. This combined amount is then adjusted pursuant to Section 275.52, Subdivision 2 (see Rev LL 38 for the maximum 6% allowable increase) to drive the current levy year's levy limit base per capita for the purpose of Section 275.51, Subdivision 3 for the first levy year subsequent to the levy year in which the levy increase was approved by referendum. Each year thereafter the levy limit base per capita (including the approved levy increase) shall be adjusted pursuant to Section 275.52, Subdivision 2 for the purpose of levy limitations determined pursuant to Section 275.51, Subdivision 3. (See Rev LL 30 for calculation of levy limits in subsequent levy years.)

A levy increase rejected by a majority of the voters of the governmental subdivision voting at a general or special election, if levied in spite of such rejection, shall be subject to the 33 percent penalty provisions of Section 275.51, Subdivision 4.

The Commissioner of Revenue is directed to prepare a suggested form of question to be presented at a referendum held pursuant to Section 275.51, Subdivision 4. The suggested form of question to be presented at such referendum is found on page 40.

Rev LL 37 Recertifications in Levy Year 1971. All governmental subdivisions were allowed to recertify their tax levies in 1971 in order to conform with the levy limitations imposed by sections 275.50 to 275.56. This suspension of the legal deadlines for levy certifications applied to levy year 1971 only.

Rev LL 38 Annual Six Percent Increase in Levy Limit Base Per Capita. The levy limit base per capita of a governmental subdivision, as determined by Section 275.51 and adjusted for previous increases pursuant to Section 275.52, is increased each year by the amount of six percent of the previous year's levy limit base per capita. The previous year's actual levy (whether above, below or at the level of the previous year's levy limitation) has no bearing on the subsequent year's overall levy limitation.

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REFERENDUM

Resolution number _____ increasing the levy of the _____ of _____

(County, city or town) (Name of governmental subdivision)

☐ Yes The following proposition shall be approved as follows.

☐ No The _____ (name of governmental subdivision) shall be authorized to exceed its levy limitation for 19____, by an amount not to exceed $_____, which may be levied on the taxable property within its boundaries in addition to all other taxes voted by it. In the next succeeding year and years following, such amount shall become a permanent adjustment to the levy limit base per capita of the _____ _____ (name of governmental subdivision.)

Rev LL 39 Population Decreases. If the population (as established pursuant to Section 275.53) of any governmental subdivision decreases from one year to the next, the current year's population shall, for purposes of the Levy Limitations Law, be increased by an amount equal to one-half of the decrease in population from the preceding year. (See Rev LL 40 for determination of population and Rev LL 41 for governing population census or estimate.) However, such increase is effective for that one particular levy year only. This population adjustment applies to decreases in population resulting from a change in a governmental subdivision or changes in the boundaries of a governmental subdivision, as well as to other population decreases.

Example 1. A governmental subdivision's population is 100,000 in 1971, 98,000 in 1972 and 95,000 in 1973. For levy year 1972 payable 1973, the current year's population figure used for the Levy Limitations Law would be 98,000 + ½ (100,000 − 98,000) = 99,000. For levy year 1973 payable 1974, the current year's population figure used would be 95,000 + ½ (98,000 − 95,000) = 96,500.

Example 2. A town with village powers has a population of 3,000 in 1972. In 1973 a portion of the town is annexed into an adjoining village. The 1973 population of the town after annexation, as determined by the Minnesota Municipal Commission in its order, is 1,800, and it continues to qualify as a "town with village powers" pursuant to Minnesota Statutes, Section 368.01. In 1974, the population of the town has increased to 1,850, and no further annexation is to occur in 1974. For levy year 1973, taxes payable in 1974, the current year's population of the town for the Levy Limitations Law would be 1,800 + ½ (3,000 − 1,800) = 2,400. For levy year 1974, taxes payable in 1975, the current year's population of the town for the Levy Limitations Law would be 1,850.

Rev LL 40 Determination of Population. For the purposes of determining the amount of tax that a governmental subdivision may levy within a per capita limitation established in accordance with Sections 275.50 to 275.56, the population of a governmental subdivision shall be that established by one of the following methods:

(a) The population as established by the last Federal or state census, incorporating subsequent corrections made by the Bureau of the Census or

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the Secretary of State, as the case may be. Unless a more recent population figure is established subsequent to the latest Federal decennial census, by means of a special state or Federal census or by a population estimate authorized by Section 275.53, the population of a governmental subdivision, for the purpose of determining the governmental subdivision's overall levy limitation pursuant to Sections 275.50 to 275.56, shall be the population as established by the last Federal decennial census as corrected.

(b) The population estimated by the Metropolitan Council. These estimates are developed between Federal census years, but are available only for governmental subdivisions within the seven counties of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott and Washington. Each non-Federal census year, the Metropolitan Council estimates the current year's April 1 population of the seven metropolitan counties and the population of each city, village, borough and township within the seven counties. These estimates are then made available the following July 1 for levy purposes in the same calendar year.

(c) The population as estimated by the Minnesota Municipal Commission pursuant to Minnesota Statutes 1971, Section 414.01, Subdivision 14, after ordering the creation of a new municipality or enlargement of an existing municipality.

(d) The population as established by a special census taken within the entire governmental subdivision pursuant to Section 275.53, Subdivision 2.

Section 275.53, Subdivision 2 provides that "the governing body of a governmental subdivision may, in any year, pass a resolution requesting the Secretary of State to take a special census for the purpose of computing the amount of tax that it may levy. Upon receiving a certified copy of such resolution, the Secretary of State shall cause such a census to be taken under his immediate supervision and under such rules and regulations as he may prescribe. The results of the census shall be certified to the governmental subdivision within three months after the Secretary of State has received a certified copy of the resolution by which the census was requested."

"The expense of taking the census shall be paid by the governmental subdivision in which the census is taken." Such expense, however, must be levied within the levy limitations of the governmental subdivision imposed by Section 275.50 to 275.56. Such an expense does not qualify as a "special levy" as defined for the Levy Limitations Law.

(e) The population as established by an estimate of the current population of the governmental subdivision, contained in a resolution passed by the governing body of such subdivision.

(1) "In lieu of passing a resolution pursuant to Section 275.53, Subdivision 2, the governing body of a municipality or town may pass by June 1 of any year a resolution containing an estimate of the current population of the subdivision." The resolution shall contain the name of the governmental subdivision and county where located, the estimate of the current population, the date of the population estimate, a detailed explanation of the criteria used in developing the population estimate, a statement that the estimate is made for the purpose of increasing that governmental subdivision's levy pursuant to Minnesota Statutes 1971, Sections 275.50 to 275.56, the date that the resolution was passed and adopted by the govern-

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ing body of the governmental subdivision, the signature of the clerk or recorder (if the governmental subdivision is a city, village, borough or town) or the county auditor (if the governmental subdivision is a county government) and the date of signature, and the official seal of the governmental subdivision.

(2) "The resolution shall then be submitted to the State Planning Agency. The Agency shall determine, and so inform the subdivision in writing within 30 days of receipt of the resolution, whether the criteria described therein do or do not provide a reasonable basis for the population estimate" and whether or not the resulting estimate itself is reasonable. "No determination by the Agency made pursuant to Section 275.53, Subdivision 3 shall constitute, nor shall it be represented as constituting, a determination of actual population."

(3) If the State Planning Agency determines that the criteria do not provide a reasonable basis for the population estimate, the resolution shall not be valid for purposes of the Levy Limitations Law and such estimate shall not be used for the purpose of determining the levy limitation of the governmental subdivision pursuant to Sections 275.50 to 275.56. If the Agency determines that the criteria do provide a reasonable basis for the population estimate, the resolution, as prepared in accordance with number (1) above and submitted to the Agency in accordance with number (2) above shall be published at least once in a legal newspaper of general circulation in the governmental subdivision. "Such estimate may then be used for computing the amount of ad valorem taxes the subdivision may levy, unless within 30 days following the publication of the resolution, 10 percent or more of the registered voters of the subdivision, or if the subdivision does not require voter registration, then 10 percent or more of its voters who voted at the subdivision's last election, sign a petition demanding a special census, and submit the petition to the governing body of the subdivision."

(4) "Attached to the petition shall be an affidavit executed by the circulator or circulators thereof, stating that he or they personally circulated the petition, stating the number of signatures thereon, and stating that all the signatures were affixed in his or their presence and that he or they believe them to be genuine signatures of the persons whose names they purport to be. Each signature need not be notarized."

(5) "Upon the receipt of a petition conforming to Section 275.53, Subdivision 3, the governing body of the governmental subdivision shall pass a resolution requesting the Secretary of State to take a special census of the governmental subdivision. The census shall be taken and financed pursuant to the provisions of Section 275.53, Subdivision 2." Once developed, the population established by this special census supersedes the population estimate contained in the governing body's resolution.

(6) "The governing body of a governmental subdivision may not avail itself of the provisions of Section 275.53, Subdivision 3 during any year for which any State or Federal census has been taken or for which the Metropolitan Council has made a population estimate of the subdivision." If none of these census figures or estimates of population for the governmental subdivision have been developed during any year, or if the only population figure developed during the year was an estimate by the Minnesota Municipal Commission pursuant to Minnesota Statutes 1971, Section 414.01, Subdivision 14, the governing body of a governmental subdivision may then de-

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termine its population for such year pursuant to Section 275.53, Subdivision 3.

Rev LL 41 Governing Population Census or Estimate. The general rule, for the purpose of determining the tax that may be levied within the per capita limitations of the Levy Limitations Law, is that the most recent population count or estimate established for the governmental subdivision, pursuant to Section 275.53, must be used. This selection pertains to the stated date of the population count or estimate and not to the date of release of the final count or estimate. If there are two population counts or estimates for a governmental subdivision, one in each of two succeeding years, the population count or estimate for the later year must be used. If, on the other hand, there are two population counts or estimates for a governmental subdivision within the same year, the count or estimate for the latest date must be used. Once the selection is made according to this rule, the final count or estimate of population, incorporating subsequent corrections, is used.

Example 1. The 1970 Federal census population figure for a city was 50,000. The Metropolitan Council developed a population estimate of 49,500 for the same city as of April 1, 1971. No other census or population estimates have been developed in 1971. In this case the city must use the estimate developed by the Metropolitan Council for levy year 1971 payable 1972. However, this estimate would be adjusted upward to 49,750 in accordance with Section 275.52, Subdivision 3, and this adjusted population estimate would be the actual figure used.

Example 2. The 1970 Federal census population figure for a village was 12,000. In 1974 the governing body developed a population estimate of 13,000 in accordance with Section 275.53, Subdivision 3, and passed and adopted the estimate by resolution dated May 1, 1974. The population estimate was approved by the State Planning Agency and was unopposed by the voters of the governmental subdivision. No other population estimate was developed in 1974. In this case, the governmental subdivision must use the 1974 estimate of 13,000 developed in accordance with Subdivision 3. If the governmental subdivision had not passed and adopted the resolution containing the population estimate until after June 1, 1974, such resolution, pursuant to Section 275.53, Subdivision 3 (a), would not be valid and the 1970 Federal census population figure would prevail.

The one exception to the general rule is that a governmental subdivision may not develop a population estimate pursuant to Section 275.53, Subdivision 3 in the same year that any other population census or estimate (except a population estimate developed by the Minnesota Municipal Commission) has been developed pursuant to Section 275.53. Section 275.53, Subdivision 3 is also superseded by any subsequent population census or estimate (including a population estimate developed by the Minnesota Municipal Commission) developed pursuant to Section 275.53.

In the event that a population estimate is developed pursuant to Section 275.53, having the same date of count or estimate as a Federal or State population census, the Federal or State census, as the case may be, shall prevail. In the event that two or more population estimates are developed having the same date of estimate, and they are the latest population figures developed pursuant to Section 275.53, and they differ numerically, then the governing body of the governmental subdivision shall choose, by resolution,

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from among these estimates the population figure which shall be governing for the purposes of the Levy Limitations Law.

Example 1. A special State census taken by the Secretary of State, pursuant to Section 275.53, Subdivision 2, counts the population of a city as of April 1, 1973, as 220,000. The Metropolitan Council estimates that the population of the city as of April 1, 1973 is 210,000. No other population estimate was developed in 1973. In this case, the population of the city established by the special State census would prevail for the purposes of the Levy Limitations Law.

Example 2. A village annexes a portion of an adjacent township. The Minnesota Municipal Commission estimates the population of the newly enlarged village as of May 1, 1972, as 8,000. A population estimate of the village developed by the village council pursuant to Section 275.53, Subdivision 3, passed and adopted by resolution dated June 1, 1972, establishes the May 1, 1972 population as 8,200. The population estimate contained in the resolution is approved by the Vital Statistics Section of the Department of Health and is unopposed by the voters of the governmental subdivision. No other population estimate or census count for the village is established for 1972. In this case, the village council must choose between the Minnesota Municipal Commission's estimate of 8,000 population and the governmental subdivision's estimate of 8,200 population.

Rev LL 42 Annexations, Consolidations and Transfers of Functions. Section 275.54 provides for the determination of levy limitations when the boundaries of governmental subdivisions change due to consolidations, mergers or other combinations and also provides for the determination of levy limitations when functions or services are transferred between governmental subdivisions.

(a) "If all or part of the area included within two or more governmental subdivisions is consolidated, merged or otherwise combined to constitute a single governmental subdivision, and differing limitations upon the amount of tax levy per capita apply to the governmental subdivisions from which the consolidated, merged or otherwise combined governmental subdivision was formed, the limitation applicable to the surviving entity for purposes of Sections 275.50 to 275.56 shall be equal to the highest limitation applicable to any one of the constituent subdivisions prior to the consolidation, merger or other combination." This applies to governmental subdivisions enlarged through mergers as well as totally new governmental subdivisions created out of all or parts of the areas of previously existing political subdivisions of the State.

Example 1. Town A with village powers and Town B with village powers operate as separate governmental subdivisions for levy year 1971, taxes payable in 1972. Portions of the two towns merge in 1972 to form Village C, a totally new governmental subdivision. The levy limit base per capita for Township A in levy year 1971 payable 1972 was $45.12 while the levy limit base per capita for Township B in levy year 1971 payable 1972 was $42.25. The levy limit base per capita for Village C (levy year 1971 payable 1972 levy limit base per capita to be used in determining the levy limit base per capita for levy year 1972, taxes payable in 1973, pursuant to Sections 275.50 to 275.56), would be $45.12, which is equal to the highest limitation applicable to one of the constituent subdivisions (Township A) prior to the merger. The remaining portion of Township A

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(the portion not incorporated into Village C) would retain its levy year 1971 payable 1972 levy limit base per capita of $45.12, unless it no longer qualified as a town with village powers. Similarly, the remaining portion of Township B (the portion not incorporated into Village C) would retain its levy year 1971 payable 1972 levy limit base per capita of $42.25, unless it no longer qualified as a town with village powers. (See Rev LL 3 for the definition of "town with village powers".)

Example 2. In 1972 a city annexes a portion of a town **without** village powers. In this case, a hypothetical levy limit base per capita must be calculated for the town without village powers. This is done by computing the levy year 1970 payable 1971 levy limit base per capita (see Rev LL 29 for the calculation of the 1971 payable 1972 levy limitations) and increasing this per capita amount by the annual six percent increase. (See Rev LL 38 for the annual six percent increase.) The result of this calculation is a hypothetical levy year 1971 payable 1972 levy limit base per capita for the township of $29.78. The levy limit base per capita for the city in levy year 1971 payable 1972 was $40.33. In this case the levy year 1971 payable 1972 levy limit base per capita to be used in determining the city's levy limit base per capita for levy year 1972 payable 1973 would be $40.33, which is equal to the highest limitation applicable to one of the constituent subdivisions (the city) prior to the merger. The remaining unannexed portion of the township without village powers would **not** be subject to the levy limits imposed by Sections 275.50 to 275.56.

Example 3. A town without village powers incorporates into a village in 1972. In this case there was no levy limitation prior to incorporation. Therefore, a completely new levy limitation must be established for this newly incorporated village. This is done by computing the levy year 1970 payable 1971 levy limit base per capita for the dissolved township (see Rev LL 29 for the calculation of the 1971 payable 1972 levy limitations) and increasing this per capita amount by the annual six percent adjustment. (See Rev LL 38 for the annual six percent increase.) The result of this calculation is the village's levy year 1971 payable 1972 levy limit base per capita to be used in determining its levy year 1972 payable 1973 levy limit base per capita.

(b) If a function or service of one governmental subdivision is transferred to another governmental subdivision, the levy limitations established by Sections 275.50 to 275.56 shall be adjusted by the Commissioner of Revenue in such manner as to fairly and equitably reflect the reduced or increased property tax burdens of such subdivisions resulting from such transfer. The aggregate of the adjusted limitations shall not exceed the aggregate of such limitations prior to adjustment.

The procedure for adjusting levy limitations to reflect the reduced or increased property tax burdens resulting from the transfer of a function or service is as follows:

(1) The levy in 1970 taxes payable in 1971 for the function or service subject to transfer is increased by six percent compounded for each levy year after 1970 up to and including the first levy year affected by the transfer. The levy for the function or service subject to transfer is the amount actually spread on the tax lists in 1970, taxes payable in 1971.

(2) The Exempt Property Reimbursement (pursuant to Minnesota Statutes 1969, Section 273.69) that the governmental subdivision was en-

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titled to receive in calendar year 1971 is allocated, on a percentage distribution basis, to the levy in 1970 payable 1971 for the function or service subject to transfer. (See Rev LL 29, clause (c) for the determination of the Exempt Property Reimbursement that the governmental subdivision was entitled to receive in calendar year 1971.) The resulting allocated amount is increased by six percent compounded for each levy year after 1970 up to and including the first levy year affected by the transfer.

(3) The final results of steps (1) and (2) are aggregated. This total amount is the amount of levy limitation transferred along with the function or service which is transferred.

(4) The amount to be transferred, determined in step (3), is divided by the population of the governmental subdivision assuming the function or service. This is the population of such governmental subdivision in the first levy year affected by the transfer, determined pursuant to Section 275.53. (See Rev LL 40 for the determination of population and Rev LL 41 for governing population census or estimate.) The resulting per capita amount is added to the current levy year's levy limit base per capita of such governmental subdivision in the first levy year affected by the transfer. This addition is a permanent adjustment to the levy limit base per capita of the governmental subdivision assuming the function or service.

(5) The amount to be transferred determined in step (3), is divided by the population of the governmental subdivision divested of the function or service. This is the population of such governmental subdivision in the first levy year affected by the transfer, determined pursuant to Section 275.53. (See Rev LL 40 for the determination of population and Rev LL 41 for governing population census or estimate.) The resulting per capita amount is subtracted from the current levy year's levy limit base per capita of such governmental subdivision in the first levy year affected by the transfer. This subtraction is a permanent adjustment to the levy limit base per capita of the governmental subdivision divested of the function or service.

Example. City A has had the function of maintaining the city library through 1972 while the county government has maintained a county library system for the county, excluding City A. Now for levy year 1972, taxes payable in 1973, the function of providing a library for City A is transferred to the county government. Prior to adjusting their respective levy limitations, City A had a 1972 population of 10,000, a levy year 1972 payable 1973 levy limit base per capita of $50.00 before adjustment, producing a total 1972 payable 1973 levy limit base of $500,000 before adjustment, 1973 local government aid of $130,000, and a 1972 payable 1973 overall levy limitation of $370,000 ($500,000 − $130,000) before adjustment. The county has a 1972 population of 20,000, a levy year 1972 payable 1973 levy limit base per capita of $40.00 before adjustment, producing a total 1972 payable 1973 levy limit base of $800,000 before adjustment, 1973 local government aid of $300,000 and a 1971 payable 1972 overall levy limitation of $500,000 ($800,000 − $300,000) before adjustment.

The total levy of the city in 1970, taxes payable in 1971 was $360,000, of which $36,000 was levied for the city library. The total Exempt Property Reimbursement which the city was entitled to receive in 1971 was $80,000. The allocation of the 1971 aid to the $20,000 library levy is $80,000 × (36,000 ÷ 360,000) = $80,000 × 0.1 = $8,000. The total amount of levy and aid apportionable to the city library for levy year 1970, taxes payable in 1971 is, therefore, $20,000 + $8,000 = $28,000. This

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amount increased by 6% compounded for the two levy years from levy year 1970 payable 1971 to levy year 1972 payable 1973 is $28,000 × 1.1236 = $31,460.80. This is the amount of levy limitation to be transferred from City A to the county government for levy year 1972, taxes payable in 1973.

The $31,460.80 divided by the 1972 population of City A (10,000) equals $3.14 per capita. This per capita amount is subtracted from the city's 1972 payable 1973 levy limit base per capita before adjustment of $50.00, thereby reducing the effective levy limit base per capita for City A to $46.86 for levy year 1972, taxes payable in 1973. This per capita amount multiplied by the city's 1972 population of 10,000 equals a total 1972 payable 1973 levy limit base of $468,600. After subtracting the 1973 local government aid of $130,000, the effective overall levy limitation for City A in 1972 payable 1973 is $338,600. The levy limit base per capita adjustment associated with the transfer of the library function is a permanent adjustment for levy year 1972 and all future levy years.

The $31,460.80 divided by the 1972 population of the county (20,000) equals $1.57 per capita. This per capita amount is added to the county's 1972 payable 1973 levy limit base per capita before adjustment of $40.00, thereby increasing the effective levy limit base per capita for the county to $41.57 for levy year 1972, taxes payable in 1973. This per capita amount multiplied by the county's 1972 population of 20,000 equals a total 1972 payable 1973 levy limit base of $831,400. After subtracting the 1973 local government aid of $300,000, the effective overall levy limitation for the county in 1972 payable 1973 is $531,400. The levy limit base per capita adjustment associated with the transfer of the library function is a permanent adjustment for levy year 1972 and all future levy years.

The aggregate of the adjusted total 1972 payable 1973 levy limitations ($338,600 + $531,400 = $870,000) is equal to the aggregate of the total 1972 payable 1973 levy limitations prior to the adjustment ($370,000 + $500,000 = $870,000).

The amount of **non-ad valorem tax** resources used to support a function or service in levy year 1970 payable 1971, except Exempt Property Reimbursement (pursuant to Minnesota Statutes 1969, Section 273.69), may not be used to adjust levy limit bases per capita when such function or service is transferred from one governmental subdivision to another.

Rev LL 43 Administrative Rules and Regulations. Section 275.55 empowers the Commissioner of Revenue to issue, in accordance with the Administrative Procedures Act (Minnesota Statutes, Chapter 15), rulings interpreting the Levy Limitations Law. These rules, in addition to other purposes relating to the Levy Limitations Law, shall be used to determine if a governmental subdivision levy qualifies as a "special levy" and to determine if a levy limitation established pursuant to Sections 275.50 to 275.56 has been exceeded.

Rev LL 44 Review of Levy Limitations. Section 275.55 delegates to the Commissioner of Revenue the responsibility for the enforcement of the provisions of the Levy Limitations Law. For this reason, the Commissioner of Revenue, or his designees, are charged with the responsibility of establishing procedures by which levies of all governmental units shall be periodically reviewed. A general description of such procedures is herewith provided.

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The overall levy limitation for each governmental subdivision in 1971, or any subsequent levy year, shall be determined by the Department of Revenue in accordance with the provisions of Sections 275.50 to 275.56. These limitations shall be the effective overall levy limitations for such governmental subdivisions. These overall levy limitations may be corrected and adjusted upon new information supplied by the governmental subdivision to the Department of Revenue.

Each governmental subdivision shall file with the Department of Revenue, in 1971 and subsequent levy years, on forms supplied by the Department of Revenue, a detailed explanation for each claim of a "special levy" or other levy outside the limitations established pursuant to Sections 275.50 to 275.56 (see Rev LL 27 for other levies outside the overall levy limitations), together with a certification of the ad valorem property tax levy certified to the county auditor for such levy year.

Upon receipt of the abstracts of tax lists transmitted by the county auditors pursuant to Minnesota Statutes, Section 275.29, the Department of Revenue shall review the taxes actually levied by the governmental subdivision, together with the certifications previously made (see above paragraph), and make determinations based on the Department's rules and regulations promulgated pursuant to Section 275.55. If the Department of Revenue determines that a "special levy" claim included in the governmental subdivision's certification and actually extended on the tax lists is not a qualified "special levy" pursuant to Section 275.50, Subdivision 5, or that a levy included in the governmental subdivision's certification and actually extended on the tax lists does not qualify under Rev LL 27 as outside the limitations established pursuant to Sections 275.50 to 275.56, such levy shall be included in the governmental subdivision's total levy which is subject to the overall levy limitation.

For the purpose of determining if a governmental subdivision levy in 1972, taxes payable 1973 is within the 1972 payable 1973 levy limitation of such governmental subdivision determined pursuant to Sections 275.50 to 275.56, the amount of 1973 Exempt Property Reimbursement that the governmental subdivision was entitled to receive pursuant to Minnesota Statutes 1971, Section 477A.02 shall be added to the payable 1973 levy of such subdivision.

Rev LL 45 Administrative Action. Section 275.55 empowers the Commissioner of Revenue to take such other administrative actions as he deems necessary in order to carry out the provisions of the Levy Limitations Law. This power includes, but is not limited to: (1) the withholding of state aid payments due a governmental subdivision pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid); (2) entering into a stipulation agreement whereby a governmental subdivision agrees to reduce its levy; (3) denying a "special levy" which does not qualify under Section 275.50, Subdivision 5 in order to prevent it from being used in the calculation of Local Government Aid payments to be made pursuant to Minnesota Statutes, 1973 Supplement, Section 477A.01; and (4) reducing Homestead Credit granted pursuant to Minnesota Statutes, Sections 273.13 and 273.135 in lieu of withholding state aid payments paid pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid), when the county auditor reduced the governmental subdivision's bonded indebtedness levy by application of Local Government Aid or Taconite Municipal Aid and correspondingly in-

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creased the governmental subdivision's levy subject to the levy limitations of Sections 275.50 to 275.56. (See Rev LL 46 for the withholding of state aids, Rev LL 47 for the reduction of levies, and this regulation for the denial of unqualified "special levies" for the purpose of Minnesota Statutes, 1973 Supplement, Section 477A.01 and the reduction of Homestead Credit in lieu of withholding Local Government Aid or Taconite Municipal Aid.)

"If the Commissioner of Revenue takes administrative action or any other action authorized by Section 275.55" which is required in order to "enforce the provisions of Sections 275.50 to 275.55, he shall give written notice of such action to the governmental subdivision affected. Such notice shall specify the actual or impending violations by the governmental subdivision of Sections 275.50 to 275.56 or the rules and regulations of the Department of Revenue pertaining thereto, describe the corrective action required including, in the case of an excess levy, reduction of the governmental subdivision's levy in the next succeeding levy year in an amount equal to the amount of the excess levy, set a reasonable period of time within which the governmental subdivision shall correct the specified actual or impending violations and caution the governmental subdivision that if the specified correction is not made within the time allowed, the state aids to the governmental subdivision pursuant to Sections 477A.01 and 298.282, as amended, will be reduced as provided in Section 275.51, Subdivision 4. The time period first allowed for correction may be extended by the Commissioner if he finds a reasonable basis for delay."

One notice which the Commissioner of Revenue may send pursuant to Section 275.55 is an order of the Commissioner of Revenue determining an excess levy and reducing Local Government Aid. This order pertains to an ad valorem tax levy extended on the tax lists which the Department of Revenue determines is in excess of the governmental subdivision's levy limitation, established pursuant to Sections 275.50 to 275.56. Such order shall show how the Department calculated the amount of the excess levy and shall inform the governmental subdivision of the amount of reduction in its state aids distributed pursuant to Minnesota Statutes, Sections 298.282 (Taconite Municipal Aid) and 477A.01 (Local Government Aid) as penalty for such excess levy. Such order shall be effective 30 days after the date of such order, unless the governmental subdivision agrees by stipulation to reduce its levy and levy limitation in the next succeeding levy year by the amount of the excess levy specified in the order, and further agrees not to levy in excess of its overall levy limitation for such following levy year. (See Rev LL 47 for reduction of levies.) Such order shall also inform the governmental subdivision of its right, pursuant to Section 275.552, to dispute the Commissioner's order within 30 days of the date of such order, and of its right to a hearing before the Levy Limitations Review Board if the Commissioner adheres to his order. (See Rev LL 48 for contested cases.) Finally, this order shall inform the governmental subdivision that if the notice of the governing body of the governmental subdivision disputing the Commissioner's order is not given to the Commissioner within 30 days of his order, his order shall be final and not subject to review before the Levy Limitations Review Board. (See Rev LL 48 for contested cases.) There shall be attached to the Commissioner's order a formal request for a redetermination of the Commissioner of Revenue's order which the governmental subdivision may choose to sign and submit to the Commissioner. There shall also be attached to the Commissioner's order a formal stipulation agreement (whereby the governmental subdivision agrees to reduce its levy and

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levy limitation in the next succeeding levy year by the amount of the excess levy specified in the order and further agrees not to levy in excess of its overall levy limitation for such following levy year) which the governmental subdivision may choose to sign and submit to the Commissioner.

If the governing body of a governmental subdivision disputes a Commissioner's order determining an excess levy and reducing Local Government Aid, and the Commissioner adheres to such order, the governing body of the governmental subdivision may submit a formal request for appeal to the Levy Limitations Review Board, subject to rules adopted by the Levy Limitations Review Board. (See Rev LL 48 for contested cases.)

Another notice which the Commissioner of Revenue may send pursuant to Section 275.55 is an order determining the disallowance of a special levy. Such order shall list the special levies claimed by the governmental subdivision which the Department of Revenue determines do not qualify as special levies pursuant to Section 275.50, Subdivision 5. Such order shall also inform the governmental subdivision that the disallowed special levies claimed by the governmental subdivision shall not be used in the determination of Local Government Aid payments to be distributed pursuant to Minnesota Statutes, 1973 Supplement, Section 477A.01. Such order shall be effective 30 days after the date of such order. This order shall also inform the governmental subdivision of its right, pursuant to Section 275.552, to dispute the Commissioner's order within 30 days of the date of such order, and of its right to a hearing before the Levy Limitations Review Board if the Commissioner adheres to his order. (See Rev LL 48 for contested cases.) Finally, this order shall inform the governmental subdivision that if the notice of the governing body of the governmental subdivision disputing the Commissioner's order is not given to the Commissioner within 30 days of his order, his order shall be final and not subject to review before the Levy Limitations Review Board. There shall be attached to the Commissioner's order a formal request for a redetermination of the Commissioner of Revenue's order which the governmental subdivision may choose to sign and submit to the Commissioner.

If the governing body of a governmental subdivision disputes a Commissioner's order determining the disallowance of a special levy, and the Commissioner adheres to such order, the governing body of the governmental subdivision may submit a formal request for appeal to the Levy Limitations Review Board, subject to rules adopted by the Levy Limitations Review Board.

If the levy of a governmental subdivision, as extended on the tax lists, is in excess of the limitation imposed on such levy pursuant to Sections 275.50 to 275.56, and such excess levy is due to the county auditor having applied Local Government Aid (Minnesota Statutes, Section 477A.01) or Taconite Municipal Aid (Minnesota Statutes, Section 298.282) to the governmental subdivision's bonded indebtedness levy and correspondingly having increased the governmental subdivision's levy subject to the limitations of Sections 275.50 to 275.56, the following shall apply. With the approval of the governing body of the governmental subdivision, the Department of Revenue will determine what the levy for bonded indebtedness would have been if the governmental subdivision's Local Government Aid had been deducted from its non-bonded debt levies only. Such determination will result in lower computed Homestead Credit payments pursuant to Minnesota Statutes, Sections 273.13 and 273.135. An adjustment will then

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be made in subsequent Homestead Credit payments in lieu of withholding state aids paid pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid). If the governing body of such governmental subdivision does not agree to a reduction in its Homestead Credit payments, the subdivision will be subject to the withholding of state aids paid pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid) unless the governing body of such governmental subdivision agrees by stipulation to reduce its levy and levy limitation in the next succeeding levy year by the amount of the excess levy specified in the Commissioner's order, and further agrees not to levy in excess of its overall levy limitation for such following levy year. (See Rev LL 46 for withholding state aids and Rev LL 47 for reduction of levies.)

Rev LL 46 Withholding State Aids. Section 275.55 empowers the Commissioner of Revenue to withhold state aids where such penalties are authorized by law. State aids pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid) may be reduced as a penalty for a levy in excess of a governmental subdivision's levy limitation established pursuant to Sections 275.50 to 275.56 under the following conditions:

(a) The governmental subdivision did not submit a formal request for a redetermination of the Commissioner's order determining an excess levy and reducing Local Government Aid within 30 days of the date of such order, and did not sign a stipulation agreement whereby the governmental subdivision would reduce its levy and levy limitation in the next succeeding levy year by the amount of excess levy specified in the Commissioner's order and further agree not to levy in excess of its overall levy limitation for such following levy year;

(b) The governmental subdivision disputed the Commissioner's order within the time allowed, the Commissioner adhered to his order, but the governmental subdivision did not appeal to the Levy Limitations Review Board;

(c) The governmental subdivision disputed the Commissioner's order within the time allowed, the Commissioner adhered to his order, the governmental subdivision appealed to the Levy Limitations Review Board, and the Levy Limitations Review Board upheld the Commissioner's order after a hearing before the Board. (See Rev LL 45 for the Commissioner's administrative action and Rev LL 48 for contested cases.)

The Commissioner of Revenue, after the due process required by the Levy Limitations Law, is empowered to withhold a portion or all of one or more Local Government Aid payments (pursuant to Minnesota Statutes, Section 477A.01) or Taconite Municipal Aid payments (pursuant to Minnesota Statutes, Section 298.282) due a governmental subdivision when such governmental subdivision has exceeded its overall levy limitation as established by Sections 275.50 to 275.56. The total amount withheld is determined in accordance with Section 275.51, Subdivision 4 (see Rev LL 35 for penalties). The penalty assessed on an excess levy is first prorated equally against the four Local Government Aid payments due to be made to the governmental subdivision during the payment year, and then applied against the Taconite Municipal Aid payment (if any) to be made in such year, and any additional remaining penalty is carried over to the subsequent year's

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Local Government Aid payments. If the penalty is assessed prior to March 15 of any payment year, the penalty shall be applied to that year's aid payments. If the penalty is assessed after March 14 of any payment year, the penalty shall not be applied until the subsequent payment year.

Example 1. City K had an overall levy limitation of $400,000 in levy year 1972, taxes payable in 1973. City K actually levied $425,000, exclusive of special levies and special assessments. The Department of Revenue reviewed the excess levy and determind that it was not a qualifying "special levy" for the Levy Limitations Law. The Commissioner of Revenue issued his order determining an excess levy and reducing City K's Local Government Aid. City K did not dispute the Commissioner's order and did not sign a stipulation agreement to reduce its levy in levy year 1973, taxes payable in 1974. Therefore, the penalty on this excess levy of $25,000, computed according to Section 275.51, Subdivision 4 (see RevLL 35 for penalties), would be $3,650, derived as follows:

Levy Limitation	=	$400,000
	×	5%
Maximum Amount Subject to 10% Penalty		$ 20,000
First $20,000 of Excess Levy @ 10%	=	$ 2,000
Additional $5,000 of Excess Levy @ 33%		1,650
TOTAL PENALTY		$ 3,650

Since the effective date of the Commissioner's order was July 1, the $3,650 penalty could not be deducted from the 1973 Local Government Aid payments to City K but would be deducted from the 1974 Local Government Aid payments to the city.

Example 2. County A had a 1973 payable 1974 levy limitation of $600,000. County A levied the $600,000 and claimed $300,000 in special levies. The Department of Revenue reviewed County A's special levies and disallowed $25,000. A Commissioner's order determining an excess levy and reducing Local Government Aid was sent to the county. Within thirty days of the date of the Commissioner's order, County A submitted to the Commissioner a formal request for a redetermination of the Commissioner's order. The Department of Revenue conducted a field audit in County A's offices, which resulted in the Commissioner adhering to his previous order. County A then submitted a formal request for appeal, signed by the county attorney, to the Levy Limitations Review Board. Notice of time and place for a hearing was sent to County A by the Levy Limitations Review Board. The hearing was held and the decision of the Levy Limitations Review Board was to affirm the Commissioner's order. County A did not appeal to the district court. In this case, the penalty on the $25,000 excess levy, determined pursuant to Section 275.51, Subdivision 4 (see Rev LL 35 for penalties), would be $25,000 times 33% equals $8,333. Since the decision of the Levy Limitations Review Board was issued in October of 1974, the $8,333 penalty could not be deducted from the 1974 Local Government Aid payments to County A, but would be deducted from the 1975 Local Government Aid payments to the county.

Rev LL 47 Reduction of Levies. Section 275.55 provides that the Commissioner of Revenue may describe as corrective action for an excess levy, the reduction of the governmental subdivision's levy in the next succeeding

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levy year in an amount equal to the amount of the excess levy. This he may do only if the governmental subdivision signs a stipulation agreement. Under a stipulation agreement, the governmental subdivision agrees by stipulation that the Commissioner's determination of an excess levy is correct and valid, and that the levy limitation and ad valorem tax levy for the next succeeding levy year, and for that one levy year only, shall be reduced by the amount of the excess levy specified in the Commissioner's order. The governmental subdivision further agrees to waive all rights of review and appeal in respect to the order of the Commissioner determining an excess levy. Under such stipulation agreement, the Commissioner agrees by stipulation not to reduce any subsequent distributions of state aids to be paid pursuant to Minnesota Statutes, Sections 477A.01 (Local Government Aid) and 298.282 (Taconite Municipal Aid) on account of such excess levy. (See Rev LL 45 for the Commissioner's administrative action.)

Example. City B had a 1972 population of 10,000, a levy year 1972 payable 1973 levy limit base per capita of $50.00 and 1973 Local Government Aid of $100,000 for a levy year 1972 payable 1973 levy limitation of $300,000 ($50.00 x 10,000 — $200,000 = $300,000). After reviewing City B's 1972 payable 1973 levy, the Department of Revenue determined that City B had an excess levy of $20,000. The Commissioner of Revenue then sent City B an order determining the excess levy. City B decided not to dispute the Commissioner's order and further decided to sign a stipulation agreement to reduce its levy limitation and ad valorem levy in the next succeeding levy year, in lieu of the reduction of its Local Government Aid payments in 1973. Since the 1973 population of City B was 10,100, the adjustment for abolished state aids was determined to be $100,000 (see Rev LL 33 for the adjustment for abolished state aids) and the 1974 Local Government Aid and Attached Machinery Aid payments were calculated to be $300,000 and $10,000, respectively, the 1973 payable 1974 levy limitation for City B after the reduction agreed to by stipulation would be calculated as follows:

1972 Payable 1973 Levy Limit Base Per Capita	$50.00
Adjustments for the 6% Yearly Increase	x 106%
1973 Payable 1974 Levy Limit Base Per Capita	$53.00
1973 Population	x 10,100
1973 Payable 1974 Levy Limit Base Before Adjustments	$535,300
Adjustment for Abolished State Aids	+ 100,000
Adjusted 1973 Payable 1974 Levy Limit Base	$635,300
1974 Local Government and Attached Machinery Aids	− 310,000
1973 Payable 1974 Levy Limitation Before Adjustments	$325,300
Adjustment for Excess Levy	− 20,000
Adjusted 1973 Payable 1974 Levy Limitation	$305,300

A levy limitation reduced by a stipulation agreement pursuant to this regulation is effective for one levy year only. Such reduction in no way affects the levy limitations of the governmental subdivision for future levy years, determined pursuant to Section 275.51, Subdivision 3 or 3a.

The reduction in a subsequent levy year's levy limitation and ad valorem tax levy is in lieu of a reduction of state aids to be paid to a governmental

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subdivision pursuant to Minnesota Statutes, Sections 477A.01 and 298.282. If a governmental subdivision chooses not to sign a stipulation agreement to reduce its levy limitation and ad valorem tax levy in the next subsequent levy year, it will be subject to a reduction in its state aids (see Rev LL 46 for withholding state aids).

Rev LL 48 Contested Cases. The governing body of a governmental subdivision to whom a notice pursuant to Section 275.55 is given may, by a majority vote of the whole governing body, decide to dispute the Commissioner's order, whether it be an order determining an excess levy and reducing Local Government Aid or an order determining the disallowance of a special levy or any other order issued pursuant to Section 275.55 (see Rev LL 45 for the Commissioner's administrative action). Notice of such decision (entered on a letter of request for a redetermination of the Commissioner of Revenue's order, supplied by the Department of Revenue when such order is issued) must be given the Commissioner within 30 days of the issuance of the Commissioner's order, or else the Commissioner's determination is final and not subject to the review of the Levy Limitations Review Board. (The governmental subdivision may also choose to sign a stipulation agreement to reduce its levy and levy limitation for the following levy year in lieu of reduction of its state aids pursuant to Section 275.51, Subdivision 4; see Rev LL 45 for the Commissioner's administrative action.)

Upon receipt of a formal notice from a governmental subdivision within thirty days of the date of the Commissioner's order, requesting a redetermination of the Commissioner's determination, the Commissioner shall conduct such further investigation of the disputed issues of fact as he deems necessary, which may include an audit of local government records contained in the offices of the governmental subdivision. There shall be allowed ten days from the date of receipt of the governmental subdivision's notice for the purpose of conducting such further investigation. Within seventeen days from the date of receipt of the governmental subdivision's notice, the Commissioner shall deliver his decision, in writing, to the governmental subdivision. If the Commissioner continues to adhere to his previous order, the governing body of the governmental subdivision shall be entitled to a hearing before the Levy Limitations Review Board.

Rev LL 49 Ranking of Limitations. Section 275.56 provides that all statutory, special law and charter provisions establishing per capita, mill or dollar limitations on the amount of taxes that a governmental subdivision may levy for general or special purposes are superseded by the Levy Limitations Law to the extent that they authorize property taxation in excess of the limitations established by Sections 275.50 to 275.56, but otherwise such other limitations are not affected by the Levy Limitations Law. If a special law, statute or charter limitation is more constraining on a governmental subdivision's levy than the overall levy limitation established pursuant to Sections 275.50 to 275.56, such special law, statute or charter limitation is still effective. However, if the overall levy limitation for a governmental subdivision established pursuant to Sections 275.50 to 275.56 is more constraining on a governmental subdivision's levy than a special law, statute or charter limitation, then the overall limitation established pursuant to Sections 275.50 to 275.56 supersedes such special law, statute or charter limitation.

Example 1. County A had an overall levy limitation of $1,600,000 established pursuant to Sections 275.50 to 275.56 for levy year 1972, taxes

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payable in 1973. A statute limitation allowed this county to levy up to $420,000 for its road and bridge fund. County A wanted to levy $430,000 for its road and bridge fund, and its proposed budget levy, excluding special levies and special assessments, was $1,586,000. In this case, County A must stay within the statutory limitation of $420,000 for its road and bridge fund, regardless of the fact that it would stay within its overall levy limitation of $1,600,000 with a $430,000 levy for such fund.

Example 2. City B had an overall levy limitation of $1,500,000 established pursuant to the Levy Limitations Law for levy year 1972, taxes payable in 1973. On the other hand, Minnesota Statutes, Section 275.11 allowed the city to levy up to $102.60 per capita, which, when multiplied times the city's population of 16,100, was a levy of $1,651,860. In this case, the Levy Limitations Law supersedes the provisions of Minnesota Statutes, Section 275.11. The city cannot exceed its overall levy limitation of $1,500,000 without being subject to the penalty provisions of Section 275.51, Subdivision 4.

Example 3. City C had an overall levy limitation of $400,000 in levy year 1973, taxes payable in 1974. A special law applicable only to City C authorized a levy of eight mills for the purpose of operating and maintaining an airport. City C's budget levy (before the airport levy of eight mills) was $360,000. The airport levy of eight mills multiplied times the city's assessed value of $6,250,000 equaled a dollar levy for the airport of $50,000. In this case, the Levy Limitations Law supersedes the special law. The city must either reduce its airport levy or other fund levies in order to stay within the overall levy limitation of $400,000, or else be subject to the penalty provisions of Section 275.51, Subdivision 4.

Any law limiting the amount of ad valorem property taxes a governmental subdivision may levy, which was enacted subsequent to the date of final enactment of Laws of Minnesota 1971, Extra Session, Chapter 31, and which authorizes an ad valorem tax levy in excess of the limitation established for a governmental subdivision pursuant to Sections 275.50 to 275.56, shall supersede the Levy Limitations Law only if such subsequent law expressly exempts levies from the limitations imposed by Sections 275.50 to 275.56.

Rev LL 50 Elections to Increase Levy. Notwithstanding the provisions of Sections 275.50 to 275.56, the levy of a governmental subdivision, excluding special levies and special assessments, may be increased above the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56 in any per capita or dollar amount which is approved by the majority of those voters of the governmental subdivision voting at a general or special election. However, any such increase is subject to other applicable statutory, special law or charter provisions establishing per capita, mill or dollar limitations on the amount of ad valorem taxes that may be levied. Section 275.58 shall not be construed as authorizing elections to increase levies above any applicable statutory, special law or charter limitation other than limitations established pursuant to Sections 275.50 to 275.56.

(a) When the governing body of a governmental subdivision determines by resolution to increase the levy of the governmental subdivision pursuant to the provisions of Section 275.58, it shall provide for submission of the proposition of an increase in the levy limit base per capita or the proposition of an additional levy, as the case may be, at a general or special election.

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Notice of such election shall be given in the manner required by the law governing elections under which the governmental subdivision operates. "If the proposition is for an adjustment to the governmental subdivision's levy limit base per capita, increasing the levy limit base per capita over the per capita amount established pursuant to Section 275.51, Subdivision 3, such notice shall state the purpose of such per capita adjustment and the per capita amount of such adjustment. If the proposition is for an additional levy, such notice shall state the purpose and maximum yearly amount of such additional levy."

(b) A levy limit base per capita adjustment approved pursuant to Section 275.58, Subdivision 1, at a general or special election held prior to October 1 in any levy year shall increase the current year's levy limit base per capita for the governmental subdivision in that same levy year by the approved per capita amount and, in addition, shall provide a permanent adjustment to the levy limit base per capita of the governmental subdivision for future levy years. A levy limit base per capita adjustment approved pursuant to Section 275.58, Subdivision 1, at a general or special election held after September 30 in any levy year shall not increase the current year's levy limit base per capita for the governmental subdivision in that same levy year, but shall provide a permanent adjustment to the levy limit base per capita of the governmental subdivision for future levy years. Such adjustment to the governmental subdivision's levy limit base per capita shall not be subject to the penalty provisions of Section 275.51, Subdivision 4, or the Commissioner's administrative action pursuant to Section 275.55, if used in accordance with the aforementioned stipulations.

Example 1. A $5.00 levy limit base per capita increase, for the purpose of hiring more policemen and providing around-the-clock police protection for City Z, was approved pursuant to Section 275.58, Subdivision 1, at a special election held prior to October 1 in levy year 1973. Prior to adjustment, the city's current levy year's levy limit base per capita for the same levy year was $40.00. The city's adjusted levy limit base per capita for levy year 1973 would then be $45.00, and such increase would be a permanent adjustment for all future levy limitations of the city computed pursuant to Section 275.51, Subdivision 3.

Example 2. A $4.00 levy limit base per capita increase, for the purpose of operating and maintaining a new park for Enterprise City, was approved pursuant to Section 275.58, Subdivision 1, at a general election held after September 30 in levy year 1974. This levy limit base per capita increase could not be used for computing the city's 1974 payable 1975 levy limitation pursuant to Sections 275.50 to 275.56. However, the city's 1974 payable 1975 levy limit base per capita of $53.00 would be increased to $57.00 and become the preceding levy year's levy limit base per capita for the purpose of determining the city's 1975 payable 1976 levy limitation pursuant to Section 275.51, Subdivision 3, and would be a permanent adjustment to the city's levy limit base per capita for subsequent levy years.

(c) An additional levy approved pursuant to Section 275.58, Subdivision 1, at a general or special election held prior to October 1 in any levy year may be levied in that same levy year and in any levy years thereafter. An additional levy approved pursuant to Section 275.58, Subdivision 1, at a general or special election held after September 30 in any levy year shall not be levied in that same levy year, except as subject to the penalty provisions of Section 275.51, Subdivision 4, but may be levied in the subsequent

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levy year and in levy years thereafter. Such additional levy is over and above the limitation imposed on the governmental subdivision by Sections 275.50 to 275.56 and shall not be subject to the penalty provisions of Section 275.51, Subdivision 4, or the Commissioner's administrative action pursuant to Section 275.55, if levied in accordance with the aforementioned stipulations.

(d) Notwithstanding any statute, special law, ordinance or charter provision to the contrary, it shall require approval of a majority (50 percent plus 1) of the voters of the governmental subdivision voting on the question to accomplish a levy limit base per capita increase or an additional levy pursuant to Section 275.58, Subdivision 1.

(e) Notwithstanding any statute, special law, ordinance or charter provision to the contrary, the governing body of a governmental subdivision may call and hold special elections pursuant to Section 275.58.

Rev LL 51 Governmental Subdivisions Under 500 Population; Exemption From Levy Limits. "Commencing with levy year 1973 and thereafter, taxes payable in 1974 and thereafter, the provisions of Section 275.50 to 275.56 shall not apply to any city, village, borough or town with village powers whose population according to the latest state or federal census is under 500." Metropolitan Council population estimates, Bureau of the Census population estimates, Minnesota Municipal Commission population estimates, estimates of population adopted by resolution of the governing body of a governmental subdivision or any other population estimate may not be used for this determination. Only a state or federal census population figure shall be used. For most cities, villages, boroughs or towns with village powers, this means the latest federal decennial census population, incorporating subsequent corrections made by the Bureau of the Census.

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13 MCAR S 1.4001 Terminal records and reports.

A. Terminal. As used herein, the word "terminal" shall mean a facility for storage of petroleum products which have not theretofore been received in this state by a licensed distributor.

B. Records and terminal reports. All operators of terminals in this state shall keep a true and accurate record of all petroleum products delivered into and withdrawn from their terminal. A terminal report on a form approved by the commissioner shall be filed for each month showing receipts, disbursements and inventories.

C. Manifests to be furnished. A manifest or a bill of lading shall be issued for each withdrawal from a terminal in this state at the time of such withdrawal. Manifests or bills of lading shall show the following information: State tax number, date shipped, name of carrier, transport permit (MDR) number, origin (point of loading), name of supplier, name and address of distributor who will report and pay the tax and/or fee (consignee), destination, kind of product and number of gallons. The state tax number may be the manifest or bill of lading number if designated as the state tax number. A legible duplicate copy of each such manifest or bill of lading shall be filed with the commissioner.

No petroleum product shall be loaded into a tank car, the cargo tank of a tank truck or a truck transport at any terminal located outside the state for shipment to a Minnesota destination unless the distributor who will report and pay the tax and/or fee (consignee) shall require that a manifest or bill of lading be issued showing the following information: State tax number, date shipped, name of carrier, transport permit (MDR) number, origin (point of loading), name of supplier, name and address of consignee, destination, kind of product and number of gallons. The state tax number may be the manifest or bill of lading number if designated as the state tax number. A legible duplicate copy of such manifest or bill of lading shall be sent to the commissioner.

6877-6885

13 MCAR S 1.4002 Transport requirements.

A. Truck transports. Any unit operated on the public highways of this state which is used to transport petroleum products shall be deemed to be a truck transport if the cargo tank has a capacity of 2,100 gallons or more.

B. Transport permits. Except as specifically authorized by the commissioner, no truck transport shall be operated in Minnesota until a transport permit for the carge tank has been obtained from the commissioner. If any person sells, trades or otherwise disposes of a cargo tank during the term of the permit, he shall immediately surrender the permit to the

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commissioner at his office in St. Paul, Minnesota, together with complete information regarding its disposal, including the name and address of any new owner.

C. Permit number. The transport permit number prefixed by the letters "MDR" shall be painted in six-inch letters and numbers in a conspicuous place on the left front and right rear ends of the cargo tank for which the permit is issued.

D. Transporter must have permit. No petroleum product shall be loaded into the cargo tank of a truck transport to be operated in Minnesota unless the operator has in his possession a valid transport permit for such cargo tank.

E. Diversions to be reported. Any supplier or transporter of petroleum products who diverts a shipment destined to a state other than Minnesota to a Minnesota destination, or who diverts a shipment from one Minnesota destination or consignee to another Minnesota destination or consignee, shall notify the commissioner within 48 hours, setting forth the mainfest number (state tax number), date, kind of product, number of gallons, the consignee to whom the shipment has been diverted and the final destination.

F. Accidents to be reported. Any transporter who while in the act of transporting petroleum products on the highways of this state has an accident involving a loss of petroleum products due to spillage, fire, leakage or any other cause, shall notify the commissioner within 48 hours, setting forth the date of the accident, the manifest number (state tax number) and date, the consignee and destination.

G. Manifest to be carried. Operators of tank trucks or truck transports transporting petroleum products in this state on which the gasoline tax and/or the inspection fees have not been assumed shall carry proof of ownership of such material (bill of lading, manifest, invoice or other identification).

6877-6886

13 MCAR S 1.4003 Distributor records.

A. Records to be kept. Licensed distributors shall keep a true and accurate record of all purchases, transfers, sales and use of petroleum products. A record shall be kept showing the following information for each receipt of petroleum products: Manifest number (state tax number), point of origin, from whom received, kind of product, gallons received and date unloaded. A daily record shall be kept of the totals of all sales of each petroleum product.

B. Sales invoices. A sales invoice shall be made for each bulk sale of petroleum products at the time of the sale, regardless of gallonage. All sales invoices issued for bulk sales shall be machine-numbered serially with numbers of at least three digits, and shall show the following: Name and address of distributor printed or rubber-stamped upon the

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invoice, date of sale, name and address of the purchaser, kind of product, price per gallon, number of gallons, and rate and amount of tax if any. The words "bulk sale," as used in this rule, shall mean any sale of a petroleum product dispensed from a truck transport or tankwagon into a storage facility. When issued for the purpose of securing refunds or credits of the Minnesota gasoline tax, the invoices shall, in addition to the aforementioned requirements, be prepared at least in duplicate, the original to be marked "Original Invoice" and given to the purchaser. The words "original invoice," as used in this rule, shall mean the first or top sheet of an invoice, bearing the original inked or penciled imprint, whether it be typewritten, handwritten or printed, issued by a seller to a purchaser covering the product or products sold. Whenever the original invoice is unavailable, the commissioner may approve the use of a copy thereof. In such cases, a lost-or-destroyed-invoice affidavit executed by the claimant, together with a supporting statement by the supplier, must be filed.

When issued for other than bulk sales and for the purpose of securing refunds or credits of the Minnesota gasoline tax, the invoices or receipts shall show the name and location of the seller, date of purchase, number of gallons and total price.

When issued for deliveries made into another state, invoices shall be issued in the same manner with a separate set of numbers.

Sales invoices used for the sale of a rejected petroleum product not meeting specifications which the commissioner has approved for sale shall bear the following notation:

"FUEL OIL -- REJECTED PRODUCT -- UNSAFE FOR HEATING OR LIGHTING PURPOSES"

"GASOLINE -- REJECTED PRODUCT -- CONTAINS OTHER PETROLEUM PRODUCTS ON WHICH THE GASOLINE TAX HAS BEEN PAID"

C. Inventories. A physical inventory shall be taken at the end of each month of all petroleum products and a record kept of the quantity in each tank, tank capacity, tank number if any, and kind of product.

D. Records to be retained. With the exception of sales invoices or receipts issued for other than bulk sales and for the purpose of securing refunds or credits of the Minnesota gasoline tax, copies of all manifests, bills of lading, invoices and delivery tickets, as well as all other records relating to the purchase, transfer, sales and use of petroleum products, shall be retained for a period of four years.

6877-6885

13 MCAR S 1.4004 Distributor and dealer credits and refunds.

A. Distributor credits, how allowed. The credits under Minnesota Statutes, section 296.14, subdivision 2, shall be

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allowed as follows:

Under clause (1), credit shall be taken prior to computing the allowance for evaporation and loss;

Under clause (2), credit on sales made directly from terminals shall be taken prior to computing the allowance for evaporation and loss; credit on all other sales shall be taken after computing the allowance for evaporation and loss;

Under clause (3), credit shall be taken prior to computing the allowance for evaporation and loss;

Under clause (4), credit shall be taken only when supported by a credit memorandum issued by the commissioner. Such credit memorandum will reflect the adjustment for the allowance for evaporation and loss.

B. Unusual losses. A written notice of any unusual loss of gasoline or special fuel by a distributor or dealer while in his possession, including gasoline or special fuel destroyed by accident, shall be given to the commissioner within 30 days after the discovery of the loss in order to qualify for credit or refund of tax paid, and, in addition, all claims of a distributor or dealer for refund or credit of gasoline or special fuel tax paid as a result of such unusual loss shall be filed with the commissioner within 90 days after the discovery of such loss.

6877-
6885

13 MCAR S 1.4005 Dealer records.

A. Records to be kept. Dealers shall keep a true and accurate record of all purchases and sales of petroleum products. Purchase records shall show the kind of product, from whom purchased, number of gallons and date unloaded. A daily record shall be kept of the total of all sales of each petroleum product.

B. Sales invoices. When issued for the purpose of securing refunds or credits of the Minnesota gasoline tax, sales invoices representing bulk sales shall be machine-numbered serially with numbers of at least three digits, and shall show the following: Name and address of the dealer printed or rubber-stamped upon the invoice, date of sale, name and address of the purchaser, kind of product, price per gallon, number of gallons and rate and amount of tax. They shall be prepared at least in duplicate, the original to be marked "Original Invoice" and given to the purchaser. The words "bulk sale," as used in this rule, shall mean any sale of a petroleum product dispensed from a truck transport or tankwagon into a storage facility. The words "original invoice," as used in this rule, shall mean the first or top sheet of an invoice, bearing the original inked or penciled imprint, whether it be typewritten, handwritten or printed, issued by a seller to a purchaser covering the product or products sold. Whenever the original invoice is unavailable,

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the commissioner may approve the use of a copy thereof. In such cases, a lost-or-destroyed-invoice affidavit executed by the claimant, together with a supporting statement by the supplier, must be filed.

When issued for other than bulk sales and for the purpose of securing refunds or credits of the Minnesota gasoline tax, the invoices or receipts shall show the name and location of the seller, date of purchase, number of gallons and total price.

When issued for the purpose of securing a refund or credit of the Minnesota gasoline tax, a separate invoice shall be issued for each sale, at time of sale, regardless of gallonage.

Invoices issued to operators of portable feed mills, corn shellers and other portable units for gasoline serviced to the unit tank, shall show separately the number of gallons, if any, serviced to the vehicle supply tank.

Sales invoices used for the sale of a rejected petroleum product not meeting specifications which the commissioner has approved for sale shall bear the following notation:

"FUEL OIL -- REJECTED PRODUCT -- UNSAFE FOR HEATING OR LIGHTING PURPOSES"

"GASOLINE -- REJECTED PRODUCT -- CONTAINS OTHER PETROLEUM PRODUCTS ON WHICH THE GASOLINE TAX HAS BEEN PAID"

C. Records to be retained. All records relating to the purchase and sale of petroleum products, excluding copies of sales invoices or receipts issued for other than bulk sales and for the purpose of securing refunds or credits of the Minnesota gasoline tax, shall be retained for a period of four years.

6877-6885

13 MCAR S 1.4006 Special fuel requirements.

A. Records. All distributors, special fuel dealers and bulk purchasers shall keep a true and accurate record of all purchases, transfers, sales and use of special fuel. They shall also keep complete and accurate records of purchases, sales and use of fuel oil and liquefied petroleum gas at all their locations where special fuel is sold or stored.

B. Sales invoices. A sales invoice shall be issued for each sale of special fuel made by a distributor or a special fuel dealer. Such sales invoices shall bear the signature of the person making the delivery, name and address of the purchaser, motor vehicle license number if delivered into the supply tank of a licensed motor vehicle, date of sale, number of gallons, rate of tax, price per gallon and total amount of sale. The words "Special Fuel" shall be written or printed on each sales invoice at the time of sale or delivery. Sales invoices shall have the name and address of the distributor or special fuel dealer printed or rubber-stamped thereon and shall be

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machine-numbered serially with numbers of at least three digits and issued in sequence. A separate sales invoice book shall be maintained for special fuel sales, and one copy of each such sales invoice shall be retained in the special fuel sales invoice book, unless otherwise authorized by the commissioner. Sales invoices issued for fuel other than for use as special fuel shall show the kind of fuel and the name and address of the purchaser.

C. Meter readings and inventories. Distributors, special fuel dealers and bulk purchasers shall at the end of each month take and record

1. through an accumulating meter in working order, meter readings for each pump through which special fuel is dispensed; and

2. physical inventories of special fuel showing quantity in each tank, tank capacity and kind of product.

D. Users' records and reports. All users of special fuel shall keep a true and accurate record of all purchases, sales, transfers and use of special fuel and shall retain all such records for a period of four years. Users of special fuel (except licensed distributors, special fuel dealers and bulk purchasers required to file monthly reports) shall file an annual information report showing the number of gallons used, miles traveled and such other information as the commissioner may prescribe, for each licensed motor vehicle. This report shall be filed on or before March 1 of each year for the preceding calendar year.

E. Mileage reports. Upon demand of the commissioner there shall be attached to and made a part of the monthly special fuel tax report an accurate statement of mileage traveled during such month on Minnesota highways by each licensed motor vehicle supplied with special fuel from the bulk storage facilities maintained by the licensee.

F. Bulk sales reports. Persons selling or delivering special fuel into storage facilities maintained by any licensed bulk purchaser shall, on or before the 23rd day of each month, file with the commissioner an itemized report, in a manner prescribed by and on a form supplied by him, showing all sales of special fuel to said licensed bulk purchaser.

G. Records to be retained. Copies of all manifests, bills of lading, invoices, sales and delivery tickets, as well as all other records relating to the purchase, transfer, sales and use of special fuel, shall be retained for a period of four years.

H. Changes in storage capacity or location. Distributors, special fuel dealers and bulk purchasers shall report to the commissioner in writing within seven days any change in storage capacity or location of special fuel facilities.

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I. Prices posted. Each pump used to dispense special fuel into the supply tank of a licensed motor vehicle by a special fuel dealer shall show the total sales price per gallon posted on the pump in a conspicuous manner.

13 MCAR S 1.4007 Other taxable products. Material used as stove or lamp gasoline, and naphtha, toluol, benzol or any like product used in blending to produce gasoline, shall be reported and the Minnesota gasoline tax paid thereon.

13 MCAR S 1.4008 Mixtures of products. All mixtures of petroleum products which occur at bulk stations, service stations or in tank trucks and truck transports resulting in a product that does not meet state of Minnesota specifications shall be reported to the commissioner promptly, setting forth the date and the number of gallons of each petroleum product mixed. Such mixtures of petroleum products shall not be moved or disposed of until authorization is given by the commissioner.

13 MCAR S 1.4009 Identification of pumps and containers. Service pumps and containers located at service stations and other outlets used for dispensing fuel oil and special fuel to the consumer shall be painted green or a color approved by the commissioner and shall be identified as to the product.

13 MCAR S 1.4010 Ownership changes. Licensed distributors, special fuel dealers and bulk purchasers shall immediately report in writing to the commissioner all changes of ownership or storage facilities.

13 MCAR S 1.4011 Records kept accessible. The books and records of all persons buying and selling petroleum products or special fuel, or using special fuel, and of all carriers of petroleum products, shall be made accessible to the commissioner at St. Paul or at any other location satisfactory to the commissioner.

13 MCAR S 1.4012 Refunds and credits.

A. Aviation gasoline and special fuel tax refunds. Claims for refund of the tax paid on aviation gasoline or on special fuel for aircraft must be filed on or before April 15 of the year following the year in which the fuel was purchased. Any such claim filed during the 15-day period from April 16 to April 30 may be honored less a penalty of 25 percent of the amount of the approved refund claim. The postmark on the envelope in which the claim is mailed determines the date of filing. Each claim must be accompanied by the original invoice receipted for payment by the supplier. The words "original invoice," as used in this rule, shall mean the first or top sheet of an invoice, bearing the original inked or penciled imprint, whether it be

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typewritten, handwritten or printed, issued by a seller to a purchaser covering the product or products sold. Whenever the original invoice is unavailable, the commissioner may approve the use of a copy thereof. In such cases, a lost-or-destroyed-invoice affidavit executed by the claimant, together with a supporting statement by the supplier, must be filed.

B. Minnesota gasoline tax refunds and credits.

1. General. The amount paid by a taxpayer-claimant during the taxable year as tax on gasoline (including gasohol) or special fuel may be credited against any income or excise tax due under Minnesota Statutes, chapter 290 to the extent that the gasoline was bought and used for a purpose other than use in motor vehicles or snowmobiles and to the extent that the special fuel was bought and used for a purpose other than use in licensed motor vehicles. The tax on aviation gasoline and on special fuel for aircraft cannot be used as a credit. If the credit for the amount paid as tax on gasoline or special fuel exceeds the tax due under Minnesota Statutes, chapter 290, the excess shall be refunded to the taxpayer-claimant.

A credit or refund may be claimed only for the amount paid as the Minnesota-imposed tax on gasoline or special fuel. No credit or refund may be claimed solely on the basis that the Minnesota tax was paid on gasoline or special fuel subsequently used outside Minnesota; that is, if no credit or refund of the Minnesota tax would be allowable with respect to a particular use of gasoline or special fuel inside Minnesota, then no credit or refund of the Minnesota tax will be allowable with respect to that particular use of gasoline or special fuel outside Minnesota.

2. Individuals. Every individual taxpayer-claimant seeking this credit or refund must file a Minnesota individual income tax return, together with a properly completed gasoline tax credit form to be furnished by the commissioner. However, individuals classified as exempt from income tax under Minnesota Statutes, section 290.05, subdivision 1, need only file the properly completed gasoline tax credit form in order to claim a refund.

3. Trusts and estates. Every trust and every estate seeking this credit or refund must file a Minnesota fiduciary income tax return, together with a properly completed gasoline tax credit form to be furnished by the commissioner. However, trusts and estates classified as exempt from income tax under Minnesota Statutes, section 290.05, subdivision 1, need only file the properly completed gasoline tax credit form in order to claim a refund.

4. Corporations. Every corporation seeking this credit or refund must file a Minnesota corporate income tax return, together with a properly completed gasoline tax credit form to be furnished by the commissioner. However, corporations

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classified as exempt from income and excise taxes under Minnesota Statutes, section 290.05, subdivision 1, need only file the properly completed gasoline tax credit form in order to claim a refund.

5. Information required. The gasoline tax credit form shall contain all of the following information:

a. The claimant's name, address and Minnesota tax identification number or social security number, whichever is applicable; and

b. If the claimant is exempt from income and excise taxes under Minnesota Statutes, section 290.05, subdivision 1, the signature of the claimant or the signature and title of the claimant's duly authorized representative, whichever is applicable; and

c. The preparer's signature, address, Minnesota tax identification number or social security number, whichever is applicable; and

d. A description of the use or uses made of the gasoline, gasohol and special fuel on which this claim is based; and

e. Dates of purchase and total gallonage of Minnesota gasohol used in boats. For purposes of this subclause and of subclause g below, the words "Minnesota gasohol" shall mean gasohol in which the alcohol contained therein has been distilled in Minnesota from agricultural products produced in Minnesota; and

f. Dates of purchase and total gallonage of gasoline and non-Minnesota gasohol used in boats. For purposes of this subclause and of subclause h below, the words "non-Minnesota gasohol" shall mean any gasohol which does not fall within the definition of "Minnesota gasohol" as set forth in subclause e above; and

g. Dates of purchase and total gallonage of Minnesota gasohol used for a purpose for which a credit or refund is allowable under clause 1 of part B of this rule, other than boat use; and

h. Dates of purchase and total gallonage of gasoline, non-Minnesota gasohol and special fuel used for a purpose for which a credit or refund is allowable under clause 1. of part B. of this rule, other than boat use.

6. Information returns. Information returns filed by partnerships and by qualifying electing small business corporations (qualifying Subchapter S corporations) must include the names and addresses of all partners or all shareholders entitled to a distributive share of the Minnesota gasoline tax credit and the amount of such distributive share to which each

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is entitled.

7. Filing requirements. A claim for credit or refund of the Minnesota tax on gasoline or special fuel shall be filed only once per calendar or fiscal year. The due date for filing such a claim shall be the same as the due date specified in Minnesota Statutes, section 290.42 for filing an income or excise tax return. For purposes of determining the due date for filing a claim, cities, counties, school districts and other organizations classified as exempt from income and excise taxes under Minnesota Statutes, section 290.05, subdivision 1 shall be treated as if they were corporations.

8. All of the provisions contained in Minnesota Statutes, chapter 290 are applicable to claims filed for purposes of securing a credit or refund of the Minnesota tax on gasoline or special fuel, including but not limited to, provisions governing the statute of limitations on allowable claims and provisions setting forth the penalties to be invoked for filing false claims.

C. Motor vehicle with a power take-off. As used in this rule, the words "motor vehicle with a power take-off" mean any motor vehicle or licensed motor vehicle whose motor is used for the dual purpose of propelling the vehicle and the operation of special equipment by means of a power take-off.

No refund or credit is allowable with respect to the tax paid on gasoline or special fuel used in a motor vehicle with a power take-off which can be operated while the vehicle is being propelled on the public highways unless such vehicle is equipped with an automatic metering device approved by the commissioner which accurately measures the amount of fuel which is consumed when the vehicle is stationary and not being propelled on the public highways.

A refund or credit is allowable with respect to the tax paid on gasoline or special fuel used in a motor vehicle with a power take-off if the vehicle has two separate fuel supply tanks, one for use when the special equipment is being operated and the other when the vehicle is being propelled on the public highways, and if the use of the fuel from the appropriate supply tank is automatically controlled.

A refund or credit is allowable with respect to the tax paid on gasoline or special fuel used in a motor vehicle with a power take-off provided that such claim is supported by complete and detailed records that will clearly and accurately establish the amount of gasoline or special fuel used for purposes other than propelling the vehicle on the public highways or provided such vehicle is equipped with an automatic metering device approved by the commissioner. Such records shall include, but not be limited to, all of the following information which is applicable to the claimant's situation: Type of operation, dates of operation, name of customer, miles traveled, hours of operation of special equipment, age of equipment, and results of

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tests determining engine performance during highway and power take-off operations. The use of separate fuel tanks and/or hubometers are not sufficient in themselves to qualify as complete and accurate records. Estimates of the amount of fuel used, regardless of how reasonable they may be, are not acceptable.

D. Off public highway use. If a motor vehicle or a licensed motor vehicle is used entirely off the public highways, a refund or credit of the tax paid on gasoline or special fuel is allowable.

If a motor vehicle or a licensed motor vehicle is used both on and off the public highways, a refund or credit of the tax paid on gasoline or special fuel used for purposes other than propelling the vehicle on the public highways is allowable provided such claim is supported by complete and detailed records that will clearly and accurately establish such amounts of fuel. Such records shall include, but not be limited to, all of the following information which is applicable to the claimant's situation: Type of operation, dates of operation, miles traveled on public highways, miles traveled on private roads, hours of travel off the public highways, age of equipment, and results of tests determining engine performance during off highway use. Estimates of such amounts, regardless of how reasonable they may be, are not acceptable.

E. Gasoline or special fuel lost by accident. No refund or credit is allowable with respect to the tax paid on gasoline or special fuel which is lost through spillage or accident except while in the possession of a distributor or dealer.

F. Gasoline not used by claimant. No refund or credit is allowable with respect to the tax paid on gasoline which has not been purchased and used by the claimant.

G. Gasoline or special fuel used by state of Minnesota. No refund is allowable with respect to the tax paid on gasoline used in motor vehicles or special fuel used in licensed motor vehicles owned by the state of Minnesota, including any of its municipalities and school districts, if such motor vehicles or licensed motor vehicles are used on the public highways.

6877-6885

13 MCAR S 1.4013 Road tax.

A. Commercial motor vehicle. "Commercial motor vehicle" means a passenger vehicle that has seats for more than nine passengers in addition to the driver, or any road tractor, or any tractor truck or any truck having more than two axles, which passenger vehicle, road tractor, tractor truck or truck is propelled by motor fuel.

B. Vehicles exempted from road tax. The following vehicles are exempted from the road tax law:

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1. All straight trucks having only two axles;

2. All motor vehicles having three or more axles on which is permanently mounted a corn sheller, feed grinder, back hoe, crane, well drilling machine or other similar equipment and the use of which on the public highways of this state is only for transporting the special equipment to and from the site of operation;

3. All commercial motor vehicles operated by this state, any subdivision thereof, the United States, or any agency of two or more states or of states and the United States in which this state participates, or to any school bus as defined by the laws of this state operated by, for or on behalf of a state or any subdivision thereof;

4. All motor vehicles which bear base license plates issued by the state of Minnesota or by states with which Minnesota has reciprocal agreements relating to motor fuel taxes. The commissioner of public safety will be furnished a list of such states and notified of any new agreements entered into or any cancellation of agreements now in existence.

C. Temporary authorizations. Any person not having a valid trip permit or who is not licensed as a motor carrier who, because of unforeseen circumstances, is required to operate a commercial motor vehicle in this state may obtain temporary authorization for operating a commercial motor vehicle in Minnesota by one of the following procedures:

1. A telegram may be sent to the Petroleum Division, Department of Revenue, requesting either a motor carrier license or a trip permit, together with a Western Union money order payable to the commissioner of revenue for the amount of either $10 in the case of a motor carrier license or $5 in the case of a trip permit. The copy of the telegram and the money order receipt shall be carried in the cab of the vehicle while it is operated in Minnesota; or

2. A trip permit may be purchased through a service company authorized by the state of Minnesota to sell trip permits. An electronically transmitted facsimile of the trip permit shall be carried in the cab of the vehicle while it is operated in Minnesota.

No more than three trip permits may be issued during any calendar year.

D. Reports of motor carriers and payment of tax. All motor carriers are required to file a road tax report each calendar quarter. The motor carrier's report shall be for a complete three-month period and is due to be filed by the last day of April, July, October and January. The report shall be on a form prescribed and furnished by the commissioner of revenue. All reports must be accompanied by a remittance for the full amount of the tax shown to be due on the report. If no travel takes

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place in Minnesota during any quarter, a report must still be filed, with the word "None" written in the appropriate column on line 4 of the return. The person who is responsible for the payment of the motor fuel used in the vehicle is liable for the filing of the report whether the vehicle is owned or leased by him.

E. Annual affidavit instead of quarterly report. The commissioner may exempt from the quarterly reporting requirements those motor carriers all or substantially all of whose mileage is within the state of Minnesota and require in such instances an annual affidavit attesting to the intrastate or substantially intrastate character of their operations provided that the enforcement of this law is not adversely affected thereby and that the commissioner is satisfied that an equitable amount of motor fuel is purchased in Minnesota by such carriers. The affidavit shall be on a form prescribed and furnished by the commissioner.

F. Records and invoices. An accurate record must be kept by all motor carriers of the following:

1. The miles traveled within and without Minnesota;

2. The miles traveled in Minnesota;

3. The number of gallons of fuel used in the entire operation within and without Minnesota;

4. The number of gallons of fuel purchased in Minnesota.

To substantiate the purchases of fuel in Minnesota, the original invoices or receipts must show the following:

1. Date of purchase;

2. Name and location of seller printed thereon;

3. Name and address of purchaser;

4. Kind of product;

5. Number of gallons;

6. Price per gallon;

7. Total sales price.

All records and invoices must be retained for a period of at least three years.

G. Surrender of motor carrier license. When the motor carrier shall voluntarily or involuntarily sell, dispose of or discontinue his business, he shall immediately notify the commissioner in writing and shall within ten days surrender his motor carrier license together with all copies of such license.

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H. Enforcement powers. The officers of the Minnesota highway patrol shall assist the commissioner of revenue in the enforcement of the provisions of the road tax act. Prosecution for violation of the road tax act may be commenced in the county in which the violation occurred or in Ramsey County.

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DEPARTMENT OF REVENUE
SALES AND USE TAX REGULATIONS

CHAPTER ONE: Tax S&U 100-199
DEFINITIONS

Tax S&U 100 Introduction. Minnesota Statutes, Chapter 297A, hereinafter referred to as the Sales and Use Tax Law, imposes a tax on gross receipts from sales at retail made after July 31, 1967 by any person. Terms not specifically defined in the Sales and Use Tax Law or these regulations will be given the meanings ascribed to them in accordance with legal, accounting, business or common usage.

Certain transactions defined in the Sales and Use Tax Law and these regulations constitute sales. All sales of tangible personal property are deemed to be "retail sales" or "sales at retail" unless made to purchasers who intend to resell the property to others in the regular course of business. The tax required to be collected by sellers on behalf of the Commissioner is based upon the "gross receipts" from sales not specifically exempt. "Gross receipts" means the total amount received for all sales at retail as measured by the "sales price" as defined in these regulations.

The use tax complements the sales tax and basically applies to the following situations:

(1) Property to be used in Minnesota purchased outside this state in a transaction that otherwise would have been a taxable sale if it had occurred in Minnesota;

(2) Property purchased for resale or other non-taxable use and used by the purchaser for a taxable purpose;

(3) Property purchased from a Minnesota vendor on which no sales tax was paid.

These regulations are arranged by subject matter in the order that provisions relating to the entitled subject occur in the Sales and Use Tax Law. Where section numbers are cited, the reference is to Minnesota Statutes.

Tax S&U 101 Person. The term "person", as defined in Minn. Stat. § 297A.01, subd. 2, includes the plural as well as the singular. The phrase "any other group or combination acting as a unit" includes groups engaged in a single project as well as those engaged in continuous or recurring activities. An example of such a group might be the faculty of a public school producing a play for the purpose of raising funds to be used for scholarships. Such a group of teachers is considered to be a person within the meaning of this regulation.

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The term includes not only natural persons or individuals but all forms of organizations, associations, partnerships, trusts, cooperatives and municipal corporations. In addition, officers, directors and agents of a corporation or association are included in the definition, as well as agents of individuals.

The term "person" also includes manufacturer's representatives, consignees, and brokers.

The term "trustee", as used in Minn. Stat. § 297A.01, subd. 2, includes a trustee or receiver appointed by a Federal court exercising jurisdiction over the estate of a bankrupt.

Tax S&U 102 Sales by transfer of title.

(a) Section 297A.01, Subd. 3(a), provides that a transfer of title constitutes a sale. Title to goods passes from the seller to the buyer in any manner and on any condition explicitly agreed upon by the parties. However, no title to goods can pass under a contract for sale prior to identifying such goods as the exact goods to be delivered under the contract. Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. Although the seller retains the legal title to the goods, title passes if the purchaser has the right to the use, possession and enjoyment of such goods. The following rules are applicable:

(1) Where the contract requires or authorizes the seller to send the goods to the buyer, but does not require him to deliver them at destination, title passes to the buyer at time and place of shipment;

(2) Where the contract requires delivery at destination, title passes upon tender there;

(3) Unless otherwise agreed, when the term is "f.o.b." ("free on board"), the place of shipment, title passes when the seller places the goods in the possession of the designated carrier, or if there is no designated carrier, the seller places the goods in the possession of a common carrier after making a contract for their transportation that is reasonable in view of the circumstances and the nature of the goods;

(4) Unless otherwise explicitly agreed, where delivery is to be made without moving the goods, and the seller is to deliver a document of title, title passes at the time when and where such document was delivered;

(5) Unless otherwise explicitly agreed, where delivery is to be made without moving the goods, and the goods, at the time of contracting, are already identified, and no documents are to be delivered, title passes at the time and place of contracting.

(b) Although the title passes in accordance with the rules stated above, unless, in the opinion of the Commissioner of Revenue, there is an intent to

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postpone, evade or avoid payment of the tax, a sale taxable under the law may be recorded and reported in accordance with the accounting methods consistently applied by the vendor.

(c) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance, revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale". For example, where a customer holds a T.V. set for a few days and thereafter returns it to the retailer, the retailer is not required to report the transaction, as there was no "sale".

(d) A transaction involving performance of a repair service, and incident thereto, a transfer of tangible personal property to the purchaser is not considered a sale for sales and use tax purposes if:

(1) the value of the property transferred is insignificant as compared to the total consideration; and

(2) no separate charge is made for such property. In such cases, the repairman is regarded as rendering a non-taxable service. However, if a separate charge is made for the property transferred, a sale within the meaning of the Sales and Use Tax Law is deemed to have occurred.

Example: A jeweler uses a spring costing him $0.25 to repair a watch. He bills the customer $6.00 for repair services. Since the cost of the spring is insignificant in relation to the charge for repair services, no sale of the spring is considered to have been made. The jeweler is required to pay a use tax on the spring if he did not pay a sales tax at the time of purchase. However, if the jeweler bills separately for the spring, he must collect a sales tax from the customer.

(e) When a manufacturer acquires special tooling which is not exempt under Section 297A.25, Subd. 1(h), to produce a product for his customer, he may or may not acquire the special tooling for sale to his customer. If he sells the special tooling to his customer, by billing the customer for the special tooling or giving the customer the right to take possession of it, the sale is subject to the sales tax whether or not the customer is outside Minnesota, because the first beneficial use of it was made in Minnesota. If he does not acquire the special tooling for sale to his customer, the manufacturer's purchase of it is subject to the sales tax.

(f) In the case of either prime or sub-contracts with the United States Government, the Minnesota manufacturer will be deemed the consumer of special tooling in the absence of explicit agreement as to title passage prior to use by the Minnesota manufacturer. If it is claimed that title passes immediately on purchase or manufacturer of the tooling, mold or die, the Minnesota manufacturer must provide one of the following as evidence:

(1) If the contract is not classified, a copy of the contract between the contractor and the United States Government which provides for immedi-

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ate title transfer from the contractor to the United States Government before use;

(2) If the contract in question is classified, a signed statement from the contracting officer or the Department of Defense auditor to the effect that the contract in question does include the provisions for immediate title transfer;

(3) If the Minnesota manufacturer holds a sub-contract with a prime contractor which provides for immediate title transfer to the prime contractor but not simultaneously from the prime contractor to the United States Government, the Minnesota sub-contractor must collect the sales tax from the prime contractor.

All other situations will be determined on the basis of the relevant facts.

Tax S&U 103 Sale by transfer of possession. In the ordinary course of business, in accordance with Section 297A.01, Subd. 3(a), a sale is usually evidenced by transfer of possession, either actual or constructive, from the seller to the buyer at the time the seller completes his performance under the contract. The most obvious example of a sale by passing of both title and possession is a sale for cash at the time of delivery of the goods.

Tax S&U 104 Leases.

A. In general. Any item which is taxable if sold is also taxable if leased. If an item is contracted for lease in Minnesota and physical possession of the item by the lessee occurs in Minnesota, a taxable transaction has occurred even if the lessee removes the property from the State for personal use. However, leased property which will be used in a trade or business outside Minnesota by the lessee without any intermediate use in Minnesota, and which will not be returned to Minnesota except in the course of interstate commerce, is exempt from tax.

All payments made pursuant to leases of tangible personal property, including mobile equipment such as motor vehicles, trailers and contractor's equipment, constitute sales made in Minnesota if such property is either garaged or principally used, including use thereof in interstate commerce for delivery or other temporary purpose outstate, by the lessee at or from a Minnesota situs of the lessee.

Example 1. Motor Freight Line, a Minnesota Company, leases ten tractor-trailers from Leasing Company. The contract is signed at the Minnesota office of Motor Freight Line, and all payments under the lease are made from this office. Motor Freight Line uses seven of the tractor-trailers to haul freight in interstate commerce to and from its Minnesota freight depot. The remaining three tractor-trailers are used to haul freight in interstate commerce to and from Motor Freight Line's depot in Illinois. From time to time, the three tractor-trailers enter Minnesota in the course of the normal interstate commerce activities of Motor Freight Line. The lease price attributable to the

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seven tractor-trailers used to haul freight to and from the Minnesota freight depot constitutes a Minnesota sale. The lease price of the remaining three tractor-trailers does not constitute a Minnesota sale.

Example 2. Amalgamated Contractors, a Minnesota company, leases a heavy-duty crane for a construction job in Iowa on a monthly basis. The payments are made by Amalgamated to the lessor in Iowa. Subsequently, Amalgamated secures a construction contract in Minnesota and transfers the crane to the Minnesota site on June 15, 1968. Lease payments due while the crane is located in Minnesota are subject to Minnesota Use Tax although such payments continue to be made in Iowa.

Example 3. Peter Smith, a resident of Fargo, North Dakota, leases a chain saw from XYZ Rental-All, an equipment leasing firm, with an office only in Moorhead, Minnesota. Mr. Smith intends to use the saw at his residence in Fargo, and takes possession of the saw from the rental firm in Minnesota. A Minnesota Sales Tax is due and payable on this transaction.

B. Leases of drive-it-yourself automobiles, trailers or other vehicles. All lease payments made pursuant to leases executed in Minnesota for drive-it-yourself automobiles, trailers or other vehicles on a mileage, hourly or other time basis are taxable, irrespective of whether such vehicles are to be used exclusively in Minnesota or are to be used in other states. Thus, where the lessee delivers the vehicle to the lessor in a state other than Minnesota, either by express agreement with the lessor or without securing prior consent, a lease payment made to the lessor in such other state constitutes consideration for a Minnesota sale.

All lease payments made in Minnesota pursuant to leases executed in states other than Minnesota for drive-it-yourself automobiles, trailers or other vehicles on a mileage, hourly or other time basis do not constitute consideration paid for a Minnesota sale. Consequently, such payments are not subject to the Minnesota Sales and Use Tax.

Example 1. Rental Agency, located in Minnesota, leases an automobile to "X". Thereafter, "X" drives the automobile to California and returns the vehicle to Rental Agency's office in Los Angeles, and there pays the total lease charge of $280.00. The lease charge constitutes a sale in Minnesota, and Rental Agency is required to include the entire $280.00 in its gross receipts subject to tax.

Example 2. Rental Agency located in New York leases an automobile to "Y". Thereafter, "Y" drives the automobile to Minnesota and returns the automobile to Rental Agency's office in this State, and there pays the total lease charge of $150.00. No part of the $150.00 payment is subject to the Minnesota sales or use tax.

C. Rentals of equipment. Contractors on occasion rent equipment temporarily idle to other contractors for short periods of time. Such rentals should be deemed to be occasional sales unless there are other factors which

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indicate clearly that the contractor leasing the equipment to others is engaged in the business of renting or leasing equipment.

Indications that a contractor is in the business of renting equipment include, but are not limited to, the following:

1. The equipment is advertised as available for rent.

2. The contractor otherwise actively solicits rental business.

3. The equipment owned or otherwise controlled by the contractor is materially in excess of the amount normally required by him in the performance of his construction contracts over an extended period of time.

4. The contractor regularly leases or rents equipment to others for extended periods of time.

D. Services of an operator furnished with rentals of equipment.

1. Certain types of equipment are only available with the services of an operator. For example, the hiring of a taxicab involves the concurrent hiring of a taxicab driver. The same is true with respect to bus companies and commercial airlines. The primary or chief activity of the taxicab company, or the bus line, or the airline, is furnishing transportation services. For all practical purposes, one cannot hire a taxicab or a bus or a commercial airline without accepting the services of a licensed operator. Consequently, the gross receipts from such transactions are not considered sales under Minn. Stat. § 297A.01, subd. 3(a).

2. There are enterprises which lease equipment either with or without operators. For example, a lessor of transport trucks will furnish a driver if the lessee so requests, or a lessor of heavy equipment will furnish an operator for a crane or caterpillar.

When a driver or operator is furnished along with the equipment, the lessor, by his employee or agent, retains control of the equipment. Accordingly, the lessor is considered to be furnishing a service rather than leasing the equipment, and the transaction is not considered to be a sale under Minn. Stat. 297A.01, subd. 3(a).

When a lessor utilizes equipment in furnishing such non-taxable services, no exemption for the purpose of resale is allowed on purchases of such equipment.

3. On occasion, an employee may use his own pickup truck to transport tools on behalf of his employer from one site to another. If the employee is not engaged in the business of leasing his truck, the transportation of the tools is, in effect, a service performed by him at the request of his employer. Any reimbursement to him is deemed to be non-taxable.

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E. Additional items or services furnished in connection with leases of drive-it-yourself equipment. If a lessor, in addition to granting a license to use or right of possession of leased property, contracts to furnish other items or services such as gasoline, oil, lubrication, maintenance (including replacement parts and labor for installation thereof or for the repair of the property in question), license fees, highway use taxes, and insurance, the deductibility of such items will be determined under the following rules:

1. Items deductible from the lease price are gasoline, maintenance labor, public liability insurance, license fees and highway use taxes.

If these items are separately stated by description in the lease agreement and by specific amounts in either the lease agreement, billing or invoice, they may be deducted in determining the amount of the lease payment subject to tax. If such items are separately stated by description only and without specification of amounts, a percentage of up to 1/3 of the lease payment may be deducted in determining the amount of the payment subject to tax, provided that the lessor has records that substantiate the accuracy of the percentage used.

2. Where the lease agreement does not specify such items, the entire payment is subject to tax.

3. Items not deductible under any circumstances are oil or lubrication, replacement parts and collision and comprehensive insurance.

F. Maintenance labor - lump sum contract. Where under the terms of a contract a lessor of tangible personal property other than motor vehicles agrees to provide full maintenance of such property and the periodic payment is a single sum covering both rental of the property and the maintenance service, a portion of such sum may be deemed a charge for maintenance labor and deducted in determining the amount of the payment subject to tax. The deduction shall be at the lessor's cost for such labor based on actual experience.

G. Leases to electing motor carrier. Effective July 1, 1971, motor carriers may elect under provisions of Minn. Stat. § 297A.211 to pay directly to the Commissioner of Revenue the tax due on the leasing of certain mobile transportation equipment and accessories used in interstate commerce. Lessors of such property need not collect the tax from the electing carriers who have been issued a motor carrier direct pay certificate. See Tax S&U 212 for rules relating to the motor carrier direct pay certificate and describing the property for which the payment of tax by the lessee may be deferred.

H. Leases to a joint venture. Charges for equipment furnished to a joint venture by the individual participants are not subject to the tax. Such charges are made for the purpose of allocating credit to the different members for providing the equipment.

I. A lease as distinguished from a conditional sales contract.

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1. Whatever interest is obtained by a lessee or purchaser is acquired under the terms of the agreement itself. Whether an agreement, which in form is a lease, is in substance a conditional sales contract depends upon the intent of the parties as evidenced by the provisions of the agreement read in the light of the facts and circumstances existing at the time the agreement was executed. In ascertaining such intent no single test, or any special combination of tests is absolutely determinative. No general rule, applicable to all cases, can be laid down. Each case must be decided in the light of its particular facts. In the absence of compelling persuasive factors of contrary implication, an intent warranting treatment of a transaction for tax purposes as a purchase and sale rather than as a lease or rental agreement may in general be said to exist if one or more of the following conditions are present:

a. Portions of the periodic payments are made specifically applicable to an equity to be acquired by the lessee.

b. The lessee will acquire title upon the payment of a stated amount of "rentals" which under the contract he is required to make.

c. The total amount which the lessee is required to pay for a relatively short period of use constitutes an inordinately large proportion of the total sum required to be paid to secure the transfer of the title.

d. The agreed "rental" payments materially exceed the current fair rental value. This may be indicative that the payments include an element other than compensation for the use of property.

e. The property may be acquired under a purchase option at a price which is nominal in relation to the value of the property at the time when the option may be exercised, as determined at the time of entering into the original agreement, or which is a relatively small amount when compared with the total payments which are required to be made.

f. Some portion of the periodic payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest.

2. These agreements are generally cast in the form of chattel leases and vary greatly. An appropriate pattern is discernible, however, and many of the agreements may be loosely defined and grouped as follows:

a. Short-term agreements which usually concern mobile equipment or relatively small articles of equipment. The "compensation for use" provisions in these agreements are usually expressed in terms of an hourly, daily, or weekly rental, and the rental rates are relatively high in relation to the value of the article. There may be an option to purchase the equipment at a price fixed in advance which will approximate the fair market value of the equipment at the time of the election to exercise the option. In this type of agreement, all costs of repairs, maintenance, taxes, insurance, etc., are obligations of the lessor.

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b. Agreements entered into by taxpayers engaged in the business of leasing personal property to others either as their principal business activity or incidental thereto. Under the terms of these agreements the amounts payable, called rental rates, are ordinarily based on normal operations or use, plus a surcharge for operations in excess of the normal stated usage. In some instances the rental is based on units produced or mileage operated. Termination of the agreement at stated periods is provided upon due notice by either party. If the agreement includes an option to purchase, the option price has no relation to the amounts paid as rentals.

c. Agreements providing for a "rental" over a comparatively short period of time in relation to the life of the equipment. The agreed "rental" payments fully cover the normal purchase price plus interest. Title usually passes to the lessee upon the payment of a stated amount of "rental" or on termination of the agreement upon the payment of an amount which when added to the "rental" paid approximates the normal purchase price of the equipment plus interest.

d. Agreements which provide for the payment of "rental" for a short original term in relation to the expected life of the equipment, with provision for continued use over substantially all of the remaining useful life of the equipment. During the initial term of the agreement, the "rental" approximates the normal purchase price of the equipment, plus interest, while the "rentals" during the remaining term or renewal period or periods are insignificant when compared to the initial rental. These agreements may or may not provide for an option to acquire legal title to the equipment upon the termination of the initial period or at any stated time thereafter.

e. Agreements similar to the arrangement in d. above, but with the added factor that the manufacturer of the equipment purports to sell it to a credit or finance company, which either takes an assignment of such an existing agreement with the user or itself later enters into such agreement with the user. In some instances, the lessor may be a trustee acting for or on behalf of the original vendor.

3. The fact that the agreement makes no provision for the transfer of title or specifically precludes the transfer of title does not, of itself, prevent the contract from being held to be a sale of an equitable interest in the property.

4. Conditional sales of personal property are, in general, recordable under the various State Recording Acts if the vendor wishes to protect its lien against claims of creditors. However, the recording or failure to record such a sales contract is usually discretionary with the vendor and is not controlling insofar as the essential nature of the contract is concerned for tax purposes.

5. Agreements are usually indicative of an intent to rent the equipment if the rental payments are at an hourly, daily, or weekly rate or are based on production, use, mileage, or a similar measure and are not directly related to

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the normal purchase price, provided, if there is an option to purchase, that the price at which the equipment may be acquired reasonably approximates the anticipated fair market value on the option date. Thus, agreements of this type described in paragraph 2a. and b. above, will usually be considered leases, in the absence of other facts or circumstances which denote a passing of title or an equity of interest to the lessee.

6. In the absence of compelling factors indicating a different intent, it will be presumed that a conditional sales contract was intended if the total of the rental payments and any option price payable in addition thereto approximates the price at which the equipment could have been acquired by purchase at the time of entering into the agreement, plus interest and/or carrying charges. Agreements of the type described in paragraph 2c., above, will generally be held to be sales of equipment.

7. If the sum of the specified "rentals" over a relatively short part of the expected useful life of the equipment approximates the price at which the equipment could have been acquired by purchase at the time of entering into the agreement, plus interest and/or carrying charges on such amount, and the lessee may continue to use the equipment for an additional period or periods approximating its remaining estimated useful life or relatively nominal or token payments, it may be assumed that the parties have entered into a sale contract, even though a passage of title is not expressly provided in the agreement. Agreements of the type described in paragraph 2d. and e., above, in general will be held to be sales contracts.

J. Time of incidence of tax. A lease of tangible personal property is a series of transactions in time units defined by the agreement of the parties. Gross receipts generated therefrom are taxable at the rate in effect at the time the obligation to pay becomes fixed under the agreement, and not at the time the payment must be or is in fact made. The initial obligation to pay becomes fixed upon the transfer of possession of the tangible personal property unless the agreement specifically sets forth another time. Subsequent obligations to pay become fixed either by the terms of the agreement, trade practices of the lessor, or practice in a course of dealing.

A lease of tangible personal property normally imposes upon the lessee multiple obligations. Each of these obligations may be treated separately by the agreement. The incidence of taxation upon each payment under the agreement will be determined by the obligation for which payment is made and the time at which such obligation to pay in fact arose.

Some obligations to pay arise by the execution of an agreement while other obligations arise by reason of the voluntary activities of the parties during the term of the agreement. For example, the lease of an automobile for a fixed period of months may give rise to an unconditional obligation to pay a minimum monthly amount and an additional obligation to pay for all miles driven in excess of a specified amount. In such cases the incidence of taxation on the minimum monthly amount would be determined at the time of trans-

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fer of possession while the incidence of taxation on the amount for excess mileage would be determined when the excess mileage was driven.

Tax S&U 105 License to use. Where a privilege to possess, use and enjoy tangible personal property is granted by the owner for a determinate time and on a fixed rental fee basis, or on some other basis that includes a fixed rental fee, and the owner surrenders possession and control under the terms of the agreement to the other party, such arrangement represents a lease. However, where the arrangement contemplates that the owner, for a consideration, will permit the other party to avail himself of the use of the property, without the owner divesting himself of physical possession thereof, such arrangement is included in the definition of the term "license to use" and thus represents a sale under Section 297A.01, Subd. 3(a).

Example: A lumber dealer sells lumber of only standard dimensions because the majority of his customers are building contractors and generally only require lumber in standard sizes. Whenever large lumber orders of nonstandard dimensions are received, the dealer will either cut the lumber himself and make an additional charge, or allow the contractor to use the sawing equipment on his premises for $15.00 per hour. The charges made by the dealer, for the use of his sawing equipment by the contractor, represent the granting of "a license to use" and are taxable.

The making available of a computer on a time-sharing basis for use by customers securing access by remote facilities shall not be considered granting of a "license to use". It shall be considered to be the providing of a nontaxable service.

Tax S&U 106 Consideration.

(a) In general. As used in Section 297A.01, Subd. 3(a) "consideration in money" refers to the amount of money whether in the form of currency, coins, negotiable instruments or scrip which the parties agree shall be paid by the purchaser.

Example 1. "M" manufacturer, purchases a machine for use in production. He pays $5,000.00 in cash and gives a $20,000.00, 90-day promissory note drawn to the order of "V", vendor. The note bears interest at six percent. The consideration in money is $25,000.00. The $20,000.00 note is still deemed to be "consideration in money" even though "V" holds it until maturity, as he may convert the note, plus accrued interest, into cash by negotiation. The accrued interest that may be paid to "V", either at the time of negotiation or at the time of maturity, does not constitute "consideration in money" for sales tax purposes in respect of the sale of the machine.

Example 2. Same facts as in Example 1, except that "V" discounts the $20,000.00 promissory note at his bank for $19,500.00. The consideration paid by "M" is $25,000.00.

Transactions described in Minn. Stat. § 297A.01, Subd. 3(a), are sales or

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purchases where effected by exchange or barter. The terms "exchange" and "barter" are used synonymously. (See Tax S&U 115 for allowable exclusions from sales price.)

(b) Trading stamps. Trading stamps which may be redeemed for premiums constitute consideration in the form of script. Redemptions by customers of trading stamps for premiums are subject to sales tax unless the premium is exempt by statute, e.g. clothing. The basis of the tax is the fixed value of the trading stamps plus any cash required for the redemption of a particular premium.

Trading stamp companies are the users of consumers of trading stamps and similar materials, e.g. booklets, catalogs, etc., and must therefore pay tax on all purchases thereof. Purchases by trading stamp companies of premiums, i.e. merchandise to be exchanged for redeemed trading stamps, are exempt as purchases "for resale".

The amount charged by a trading stamp company to a dealer for the privilege of distributing trading stamps which are redeemable by the trading stamp company either in cash or premiums is exempt.

(c) Coupons. Whether coupons constitute consideration in the form of scrip is dependent upon the nature of the coupon. Coupons will generally be one of two types:

(1) Coupons which are of such a nature that the retailer does not have recourse to his supplier, distributor, or product manufacturer for reimbursement. These coupons, upon tender to the seller, result in a reduction of the sales price by the seller and are not a part of the consideration paid. The net amount is subject to the tax.

(2) Coupons that are redeemed by the retailer who in turn is reimbursed by his supplier, distributor or product manufacturer are scrip and a part of the consideration. The value of such coupons is included in the amount subject to the tax. The value of the coupon is equal to the difference between the normal selling price and the reduced selling price of the merchandise.

Tax S&U 107 Producing, fabricating, printing or processing of property furnished by consumer. Where a consumer, either directly or indirectly, furnishes material or other components of a product, the sale of which is taxable under the Sales and Use Tax Law, the production, fabrication or processing of such property for such consumer is a sale under Minn. Stat. § 297A.01, subd. 3(b). Producing, fabricating and processing include any operation which results in the creation or production of tangible personal property, or which is a step in a process or in a series of operations resulting in the creation or production of tangible personal property.

Application of labor to tangible personal property so that such property may continue to be used in the same form and for the purpose for which

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acquired represents repairs and does not constitute producing, fabricating or processing of property. Where the expenditure is made for the purpose of modifying, altering or assembling it in some other manner, the application of labor thereto represents a sale under the provisions of Minn. Stat. § 297A.01, subd. 3(b).

Example 1. Customer enters into agreement with upholsterer whereby latter will remove old fabric from Customer's living room sofa and replace it with fabric chosen by Customer. The cost agreed upon is $300.00. Service charges are $150.00, with remaining $150.00 representing the cost of the materials. As the reupholstering repair permits Customer to continue to use sofa for the purpose for which acquired, only the $150.00 for material represents a sale, provided the charges for materials are billed separately, and that such charges represent a reasonable sales price for such material were it purchased without the service charge for reupholstering. If Customer had furnished his own material, no sale would have resulted.

Example 2. Customer furnishes material which is thereafter produced into a slipcover for sofa. The charge for producing the slipcover is a sale in accordance with Minn. Stat. § 297A.01, subd. 3(b), since it results in the modification of tangible personal property. If Customer had purchased material from the upholsterer, the entire cost to Customer would be a sale.

Example 3. Custom sawing of logs by a saw mill where logs are furnished by the customer constitutes a sale.

Example 4. Developing prints of home movies or stills for customers who furnish the exposed film constitutes a sale.

Example 5. Printing on paper stock furnished by customers constitutes a sale.

Example 6. Reproducing copies of typewritten or printed matter on a stock furnished by customers constitutes a sale.

Example 7. Recapping of a tire carcass supplied by the customer is a repair. If the materials and labor are separately stated, only the material portion is taxable. If no separation is shown on the invoice, the entire amount is taxable. These rules apply even though the new cap is of a different tread design, i.e. a snow tread cap applied over a summer tread, or vice versa. If a carcass is traded in for a recapped tire, the entire charge, less allowance for the trade-in is taxable. (See Tax S&U 115.)

Example 8. Cutting and milling charges by a lumberyard or woodworking shop, and pipe cutting or threading charges by a hardware store or plumbing shop are taxable whether the materials are supplied by the buyer or the seller.

Example 9. Engraving of an item furnished by the customer is considered a service not subject to tax. This "service engraving" is to be differentiated from "product engraving" which is taxable. "Product engraving" is billed

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along with or included in the sales price by the seller at the time the item is sold.

Example 10. The entire amount charged for the initial electroplating, heat treating or painting of tangible personal property furnished by the customer is taxable as fabrication labor.

Example 11. Collating and assembling done by stapling or using a similar process affixing items together is taxable. The punching, assembly, stamping, burning, electroplating, etc. of goods supplied by a customer is taxable.

Example 12. A locksmith changes a combination on a safe or changes the tumblers in a lock so that a different key must be used. The transaction is considered to be a non-taxable service and the locksmith is required to pay the sales or use tax on his purchases of the parts and materials used to perform such service. However, retail sales of keys and parts which are billed separately are taxable.

Tax S&U 108 Meals and drinks.

A. In general. Under Minn. Stat. § 297A.01, subd. 3(c), the furnishing, preparing or serving for a consideration, of food, meals or drinks is a taxable sale. However, such taxable sales do not include (1) furnishing, preparing or serving of food, meals or drinks by hospitals, sanitariums, nursing homes or senior citizens' homes; (2) serving of meals and lunches at public and private schools, universities or colleges; and, (3) the furnishing, preparing or serving of an occasional meal by a charitable or church organization; or (4) meals or drinks purchased for and served exclusively to individuals who are 60 years of age or over and their spouses or to the handicapped and their spouses by governmental agencies, nonprofit organizations, agencies, or churches or pursuant to any program funded in whole or part through 42 USCA sections 3001 through 3045, wherever delivered, prepared or served.

B. Criteria for determining taxability. Whether a particular transaction constitutes the furnishing, preparing or serving of food, meals or drinks under Minn. Stat. § 297A.01, subd. 3(c), and thus is taxable, or whether it constitutes the sale of food products under Minn. Stat. § 297A.25, subd. 1(a), and thus is exempt, will depend upon a number of factors set forth below. For purposes of brevity and convenience, the furnishing, preparing or serving of food, meals or drinks taxed under Minn. Stat. § 297A.01, subd. 3(c) will be referred to as sales of "taxable food", and sales of food products exempted under Minn. Stat. § 297A.25, subd. 1(a) will be referred to as sales of "exempt food". Food prepared for immediate consumption, that is, food which will ordinarily be consumed without delay and without further preparation or storage, is generally described as a "meal". "Drinks" are generally thought of as alcoholic or other prepared liquids.

1. As a general rule, a sale of "taxable food" occurs when any of the following conditions exist:

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a. The vendor is in the business of selling "meals" or "drinks";

b. The food sold is ready for immediate consumption;

c. The food sold is usually consumed on the vendor's premises; or

d. The vendor furnishes tables, counters, chairs, trays, glasses, cups, dishes or other eating utensils.

2. As a general rule, a sale of "exempt food" occurs only if all of the following conditions exist:

a. The food is sold in an unheated state;

b. The food is of a type commonly sold in food stores such as supermarkets and grocery stores, which are not engaged in the prepared food business;

c. The food is sold in the same form, condition, quantities and packaging as commonly sold in food stores; and

d. The food is of a type not otherwise taxable when sold by food stores.

3. Generally, food will be "taxable food" when furnished, prepared or served by restaurants, cafeterias, delicatessens, lunch counters, coffee shops, snack bars, eating houses, hotels, motels, lodging houses, drug stores, diners, bars, vending machines, drive-ins, mobile sales units, clubs, caterers, and similar businesses, including all those required to be licensed as eating places under Section 157.03, regardless of whether or not meals or drinks are served regularly to the public by such vendors.

4. Food items which are ordinarily sold for immediate consumption will be "taxable food" where sold on a "take out" or "to go" order, packaged or wrapped, and taken from the premises for consumption elsewhere. However, soft drinks in large unopened containers (e.g. quart, gallon, carton, etc.) and prepackaged ice cream (e.g. pint, quart, gallon or larger), whether packaged by the vendor or his supplier, are sales of "exempt food", since, because of the volume and packaging, they are not ready for immediate consumption and are not customarily consumed on or near the vendor's premises.

5. Heated food or drink, regardless of form, condition, quantities and packaging is "taxable food". Chicken, barbecued spareribs, fish, spaghetti, pizza, chow mein, french fries, coffee, tea, etc., are "taxable food" whether sold by restaurants, caterers, food stores or vending machines.

6. Cold sliced roast beef, corned beef, ham cold cuts, etc., although already cooked and ready to be eaten, are "exempt food", provided they are sold in the same form, condition, quantities and packaging commonly used

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by food stores, i.e., by the pound weight. Cold salads, beans, cole slaw, etc., are "exempt food", provided they are sold by the pound, quart or pint, as in food stores.

7. Sales of both taxable heated food and exempt unheated food in combination are taxable in full if sold as plates or packaged as dinners. For example, if an individual purchases a quantity of cooked, heated chicken, two quarts of potato salad and a pint of cold beans, and a separate amount is charged for each item, only the cooked, heated chicken will be "taxable food"; however, if the same items are sold in combination for a single unit price, the entire combination is "taxable food". Frozen or other packaged combinations of food commonly sold by food stores are "exempt food".

8. Pretzels, potato chips, pies, frozen ice cream sundaes and popsicles are "exempt food" when they are of the same type, and are sold in the same form, condition, quantities and packaging as they are commonly sold in food stores. For example, all beverages dispensed in cups and milk sold in half-pint or one-third-quart containers are "taxable food" because food stores do not commonly sell beverages in cups or milk in small quantities. Pretzels and potato chips are sold by grocery stores in cartons containing six individual, lunch or snack servings and these are exempt food; however, a tavern, cafeteria or vending machine sells these individual servings separately and as they are not in the same quantity and packaging as sold in grocery stores, are "taxable food".

9. Hand-prepared or dispensed ice cream cones and sundaes, from either soft or regular ice cream, are "taxable food".

10. A vendor of "exempt food" may maintain facilities for the serving of "taxable food". The sales in each category must be recorded separately, either by means of separate sales areas and separate cash registers, or by other appropriate arrangements. For example, Department Store sells food products and baked goods at retail, and operates a counter nearby where "meals" are served. The retail food section and the lunch counter record sales on separate cash registers located in their respective areas. Consequently, the food in the retail food section is "exempt food", and the food at the lunch counter is "taxable food".

11. A food store is engaged primarily in the sale of "exempt food" such as meat, fresh vegetables and fruits, canned goods, dairy products etc., which the purchasers carry away. However, a food store might also prepare "taxable food" on the premises, although there are no facilities for consuming it. For example, Supermarket sells chicken roasted on a rotisserie on the premises. Because the chicken is prepared by the vendor and sold in a heated state, the roasted chicken is "taxable food". However, bakery products, such as doughnuts, bread and pastries prepared and sold by food stores and bakeries for home consumption are "exempt food".

12. A vendor engaged principally in the sale of "taxable food" may also sell "exempt food" when it is sold by the vendor in the original or unopened

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carton. For example, a customer orders and eats "taxable food" on the premises of a pancake house and then purchases a container of their specially prepared syrup to take home. The sale of the syrup is a sale of "exempt food".

13. Sales of candy and candy products are sales of "exempt food" wherever and by whomever made.

14. The gross receipts from charges for opening and serving of customer furnished beverages i.e., "corkage" constitutes a taxable sale.

C. Meals at hospitals, sanitariums, nursing homes or senior citizens' homes. Meals furnished, prepared or served on the premises of hospitals, sanitariums, nursing homes or senior citizens' homes are not taxable, only if they are furnished, prepared or served by such institution. For example, the ladies' auxiliary of a hospital operates a coffee shop on the premises. Although the ladies' auxiliary is a nonprofit organization the food and drinks at the coffee shop are taxable since they are not furnished, prepared or served by the hospital itself.

"Hospital, sanitarium or nursing home" means any institution, place, building or agency in which accommodation is maintained, furnished or offered for the hospitalization of the sick or injured, maternity care, or for the care of three or more aged or infirm persons requiring or receiving chronic or convalescent care. The terms do not include hotels or other similar places that furnish only board or room or both to their guests.

A senior citizens' home is one that furnishes room, board, recreational facilities and nursing attention to persons who have reached the age of 65, or who, for other reasons, enter such a home at an earlier age. A senior citizens' home may be operated either for profit or on a non-profit basis.

D. Meals at schools. Meals furnished, prepared or served at public and private schools, universities or colleges are non-taxable. Administrative Offices located off the school premises are not considered part of the school and therefore meals served at those offices are taxable.

A "public school" is one that furnishes courses of study, enrollment and staff that meet the standards of the State Board of Education.

A "private school" is one that provides an education substantially equivalent to that furnished at a public school, under the rules and standards of the State Board of Education.

E. Occasional meals by a charitable or church organization.

1. The occasional furnishing, preparing and serving, for a consideration of a meal by a charitable or church organization is not taxable unless the activity is such that the organization is considered to be in the business of furnishing, preparing or serving meals. This provision applies only to occasional meals by "charitable or church organizations" as defined in Tax S&U 415(b)

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and (c). No provision is made for non-taxable occasional meals by educational organizations or other non-profit groups such as Boy Scouts, American Legion, Jaycees, etc.

2. Any occasional meal conducted by a charitable or church organization either on its property or adjacent thereto is not taxable.

3. When a meal is conducted at a location other than its own or adjacent property, and is in operation for two or more days consecutively the charitable or church organization is in the business of furnishing, preparing or serving meals at that location, and the meals there are taxable.

4. The furnishing, preparing or serving for a consideration of meals by a charitable or church organization described in 3. will not affect the non-taxable status of meals furnished, prepared and served by the organization on its property or adjacent thereto. For example, First Church prepares and serves Sunday night suppers once a month for a consideration on its own premises. During the State Fair, First Church operates a concession on the fair grounds at which it prepares and serves meals for a consideration for several consecutive days. The meals served at the fair grounds are not occasional meals and thus are taxable, but the monthly Sunday night suppers are not taxable.

5. Meals prepared or served by a hotel, catering firm or other commercial enterprise for a charitable or church organization are not occasional meals. Thus, the consideration paid to the hotel or caterer for such meals by the organization, its members or the general public is taxable.

6. When a meal by a charitable or church organization is taxable under 3. or 5. or a meal by any other non-profit organization is taxable as explained in 1., and the price is in excess of the normal selling price of such a meal, and a contribution to the organization is intended and is shown separately on the tickets or advertising, only the normal selling price of the meal is taxable. For example, Political Party arranges a $100 per plate dinner at a hotel to raise funds. The normal price of the dinner served is $6. The taxable sales prive is $6 per dinner served; the remaining $94 is a contribution to Political Party.

F. Education programs and children's camps. Tuition or fees paid for participation in educational programs provided by educational institutions or for attendance at children's camps licensed under Minn. Stat. §§ 144.71 through 144.76 are not sales at retail within the provisions of the Sales and Use Tax Law. Such tuition or fees are consideration for recreational or educational services rendered and are not taxable.

Educational institutions and children's camps sponsoring or fostering such educational or recreational programs are not retailers of meals or lodging within the provisions of the Sales and Use Tax Law since the meals and lodging provided are incidental to the recreational and educational purposes of the programs. Consequently, the meals and lodging provided, if furnished on the premises of the educational institution or children's camp, are not taxable.

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G. Meals furnished to employees. If an employer furnishes meals to his employees for a consideration, the transactions are taxable sales. However, if an employer furnishes meals to his employees for no consideration, there is no taxable sale. Where exempt meals are served to tohers, for example, meals served at a public school, the meals served there to employees will also be exempt although such employees may be required to pay for the meals.

H. Caterers. The term "caterer", as used herein, means a person, including those licensed under Minn. Stat. ch. 157, engaged in the business of preparing food, meals or drinks and serving them on the premises designated by his customers. The term "caterer" does not include employees hired by the day or hour. When an agreement provides that a caterer will prepare and serve food, as meals or buffet style, for a stated price per meal, for a lump sum or for a price per plate used, the transaction will be a taxable sale under Minn. Stat. § 297A.01, subd. 3(c). Catered meals served at schools do not constitute taxable transactions.

Any charges made by a caterer for such items as tableware, tablecloths, tables or chairs are taxable. If the customer has the option of having these items supplied by the caterer or otherwise arranging for them and the caterer's charge is adjustable accordingly, the furnishing of such items shall be considered to be the rental of tangible personal property and the caterer may rent or purchase such items exempt for resale.

If the customer does not have the option of arranging for the furnishing of such items himself for a reduction in the caterer's charge, the entire charge shall be considered to be for the furnishing, preparing or serving of meals for consideration. The caterer shall be regarded as using the items in rendering his services rather than as leasing them. The resale exemption would not be applicable to the caterer's purchase thereof when the caterer's operations are conducted in this manner.

In the event that a caterer prepares or serves meals for an organization which "resells" the meals to it members or the general public, the transaction between the caterer and the organization is a taxable sale unless the organization:

1. Holds a Minnesota Sales and Use Tax Permit;

2. Is, itself, regularly engaged in the business of furnishing, preparing or serving for a consideration food, meals or drinks; and

3. Furnishes to the caterer a properly completed Resale Exemption Certificate, Form ST-5.

I. Fraternities and sororities. "Fraternities and sororities" are student social organizations operated at or near public or private schools, colleges or universities. Fraternities, sororities and other such groups of individuals who reside at common locations and jointly share household expenses of meals, room and other items are not considered to be making taxable sales when meals are furnished to members and occasional guests.

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However, when such groups hire a caterer to serve meals on the premises in accordance with H., the consideration paid for such meals represents a taxable sale.

J. Meals served by transportation companies. The furnishing, preparing or serving of food, meals or drinks by railroad, pullman car, airline or other transportation companies which are operated in or through the State of Minnesota are taxable sales when ordered within the boundaries of Minnesota, regardless of whether or not the meals so ordered are subsequently consumed in Minnesota. Where food or meals are served by a transportation company as part of its transportation service, and no separate charges are made therefore, no sale of a meal within the meaning of the sales and use tax law is deemed to have occurred. Thus, the transportation company may not purchase such prepared meals for resale and the sales of such meals in Minnesota to the transportation company are taxable retail sales.

K. Cover or minimum charges. Cover or minimum charges, whether listed separately on the bill or collected as an admission fee or fixed charge, which entitle the patron to receive food, meals, drinks, entertainment, dancing, etc., are taxable. If food, meals or drinks are furnished prepared or served at locations other than the place of business of the vendor or in a room other than a regular dining room, and an extra charge is made for such service, the entire amount is taxable.

L. Tips. A tip given voluntarily by a customer to an employee of the retailer is not includible in the gross receipts of the retailer.

An amount paid as a service charge in lieu of a tip which is added to the customer's bill whether added by the customer or the retailer, is not subject to the sales tax if: (1) it is separately stated on the bill; (2) no part of the service charge goes directly to the vendor-employer as operating revenue; and (3) all of the amount is directly distributed to "tip employees." "Tip employees" are those employees who by social custom of the area normally receive tip income as a supplement to their regular fixed wages.

In the event any of the foregoing conditions of Tax S&U 108(1) are not met, the amount of the charge for which such conditions are not met will not be deductible from gross receipts of the retailer.

M. Purchases by vendors of meals and drinks. The vendor of meals or drinks must pay the tax on all purchases of equipment and products used or consumed in his business, including fixtures, linens, silverware, glassware, steak markers and paper products such as table cloths, place mats, towels, toilet tissue and doilies. Vendors of meals are specifically excluded from the class of vendors considered to be engaged in production as defined in Minn. Stat. § 297A.25, subd. 1(h); consequently, sales of electricity, gas, steam and all other items (except food products and disposable containers as herein defined) to vendors of meals are taxable. Non-reusable items such as souffle cups, straws, ice, swizzle sticks, paper napkins, and paper, plastic or wooden plates, cups, forks, toothpicks, etc., which are used or consumed by the cus-

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tomer as an integral part of the meal or drinks are considered sold therewith. Sales of such items for this purpose to persons engaged in the business of selling meals or drinks are, accordingly, sales for resale.

Tax S&U 109 A. Admissions and use of amusement devices. Under Minn. Stat. § 297A.01, subd. 3(d), the granting of admission to places of amusement or athletic events, and the privilege of use of amusement devices constitute sales, where such places of amusement, athletic events or amusement devices are located within Minnesota.

Example 1. "A" purchases four tickets at the University of Minnesota Athletic Ticket Office for a football game to be played at Madison, Wisconsin, between the University of Minnesota and the University of Wisconsin. The sale of the tickets to "A" does not constitute a sale under Minn. Stat. § 297A.01, subd. 3(d).

Example 2. "A" purchases four tickets from the University of Iowa Athletic Ticket Office for a football game to be played at Minneapolis, Minnesota, between the University of Minnesota and the University of Iowa. As the granting of the privilege of admission is at a place in Minnesota, the sale of the tickets to "A" constitutes a sale under Minn. Stat. § 297A.01, subd. 3(d).

Admission charges to any places of amusement or athletic events within Minnesota, therefore, constitute a sale. The following partial list is illustrative:

Admissions to all athletic events, including those staged by educational institutions;
Admissions to musical concerts;
Admissions to dances;
Admissions to motion picture theaters or theaters presenting stage shows and plays;
Admissions to golf courses and tennis courts;
Admissions to skating rinks and swimming pools;
Admissions to skate, county or other fairs;
Admissions to carnival rides and hay and sleigh rides;
Admissions to bingo games and privilege of use of bingo cards; and
Admissions to a museum.

Consideration paid for the use of athletic or amusement devices or games constitutes a sale. Amusement devices are defined as "property used in whole or in part to obtain amusement, entertainment or diversion." The following partial list is illustrative:

Use of billiard or pool tables;
Use of pinball machines, shuffleboards, etc.;
Use of bowling alleys;
Use of lift device on a ski slope;
Use of trap-shooting facilities;
Use of golf driving range facilities, etc.;

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Privilege of selecting and listening to a recording on a mechanical device commonly referred to as a juke box.

B. Entry fees–Entry fees are payments required as a condition to participation in a competitive event. That portion of an entry fee assignable to admissions or the use of amusement devices is a sale under Minn. Stat. § 297A.01, subd. 3(d) and taxable. If the entry fee to a competitive event requiring admissions or the use of amusement devices does not separately state that portion of the fee assignable to them, the entire fee is taxable.

C. Club dues–membership dues to clubs such as country clubs, tennis clubs and curling clubs are not taxable. This includes various forms of membership dues whether social and/or activity membership dues. However, payments to associations or organizations which only entitle the payee to attend concerts or events sponsored or held by the association each year are taxable as the granting of admissions to a place of amusement.

D. Tours–the charges made for aircraft, bus, boat, sightseeing rides or tours are considered non-taxable as being transportation services. They are not classified as the granting of the privilege of admission to places of amusement or the privilege of use of amusement devices.

E. Carnival rides–the gross receipts are fully taxable. If a carnival or amusement company charges a lump sum fee to a sponsor, and the sponsor allows its patrons, members, etc. to avail themselves of the carnival or amusement rides free of charge, such lump sum charges are subject to sales tax. In such a case, the sponsor is considered to have been granted the privilege of admission.

F. Recreational areas–A recreational area where no facilities are provided other than parking lots, fire pits, docks, tables, and facilities required for the preservation of the area itself is not considered a place of amusement; therefore, entry fees to such areas are not taxable. However, if the entry fees include the privilege of using tennis courts, golf courses, ski lifts, boats, snowmobiles, etc. all of which are furnished by the owner, the charges are taxable.

Tax S&U 110 Lodging. Under Section 297A.01, Subd. 3(e), furnishing for a consideration of lodging and related services by a hotel, rooming house, tourist court, motel or trailer camp and the granting of any similar license to use real property other than the renting or leasing thereof for a period of thirty days or more constitute a sale. See Tax S&U 108(f) for rules exempting lodging furnished in connection with educational programs and children's camps.

The following criteria will be applicable in determining whether a license to use real property for lodging purposes constitutes a sale under Section 297A.01, Subd. 3(e):

A lease of or license to use specific real property enforceable for a period of thirty days or more and which requires serving a notice of intention to so

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terminate either by the lessor or lessee of a period of at least thirty days prior thereto (or such shorter period as agreed to by the parties for violation of the lease conditions) does not constitute a sale even though the rent may be paid on a weekly or semi-monthly basis;

A lease of or a license to use real property where the consideration therefor is paid or payable at periods of less than thirty days' duration, or where the parties are not bound by an enforceable contract to give prior notice of thirty days or more of intention to terminate constitutes a sale;

A person engaged in the furnishing of taxable lodging facilities, in determining the amount of consideration received subject to the tax, shall exclude therefrom separately stated charges for telephone service, but shall include as taxable consideration, amounts received for the use of a television set or other items of tangible personal property.

Example 1. Guest registers at Hotel without entering into an enforceable agreement whereby he will occupy a room for a period in excess of thirty days. He occupies the room assigned to him for five full weeks. Thereafter, he settles his account and vacates the room. Although occupancy was in excess of the statutory period of thirty days, the transaction constitutes a sale in accordance with the above.

Example 2. Hotel, in addition to furnishing sleeping accommodations and related service to transients, leases rooms or suites to ten persons on a monthly basis. "G", guest, occupies a small suite, and pays in advance on the first day of each month. The leasing of a suite to "G" does not constitute a sale, as a hotel also may be a lodging house, and "G", who is a tenant at will, is required to give notice of termination of at least thirty days.

Example 3. "T" tenant, rents an apartment from "L" without a lease. "T" pays rent weekly. Each of the parties is required to give notice of one week of intention to terminate. Consequently, this arrangement constitutes a sale, as the leasing of the premises to "T" is for a period of less than thirty days.

Example 4. Motel charges Guest $12.00 per day for a room. Guest makes three local telephone calls. Motel bills Guest for $12.00 plus a separately stated charge of $ .45 for telephone calls, and $1.00 for use of a television set. The taxable consideration paid by Guest is $13.00 represented by the $12.00 charge for the room and $1.00 charge for the television set.

Example 5. If "X" Company leases a specific room in a hotel or motel on a yearly basis for occasional use by employees or guests, the charge is exempt. If under the lease, a particular room is not reserved for the exclusive use of "X" Company, the charge made therefor is taxable.

Tax S&U 111 Utilities. Under Section 297A.01, Subd. 3(f), the furnishing for a consideration of electricity, gas, water or steam for use or consumption within Minnesota, and local exchange telephone service and intrastate toll service (irrespective of whether such telephone service is obtained through

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regularly organized telephone companies or through municipal corporations operating in a propriety capacity), constitute sales. Coin-operated telephone service is excluded from the definition of "sale". See Section 297A.25, Subd. 1(h), and other clauses under this section for exceptions.

Local exchange telephone service means service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange operated to furnish subscribers inter-communicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge.

Consequently, for purposes of Section 297A.01, Subd. 3(f), charges made by the vendor (the organization furnishing telephone service) for telephone service within the area stipulated on Exchange Boundary Maps on file with the Minnesota Public Service Commission, constitutes sales. Intrastate toll service is also subject to tax. Intrastate toll service is that which is furnished outside of the local exchange but within the State of Minnesota for an additional specified charge over and above the amount charged for the local exchange service. The following example is illustrative:

"S", subscriber, pays $6.00 per month for local exchange service. In addition, during a certain month, he pays $20.00 for telephone service to other parts of Minnesota outside his local service area, and $30.00 for long distance calls made to other states. The $6.00 per month charge for local exchange service, and the $20.00 paid for outside calls within Minnesota are both subject to tax. The charge of $30.00 for long distance calls made to other states does not constitute a sale.

Transitional sales–Corporations or organizations including municipal corporations furnishing electricity, gas, water or steam to customers shall use the following criteria to determine the rate of tax applicable to the sale.

(1) If the billing includes service for any date before November 1, 1971, the 3% rate is applicable. For example: A billing for service from October 30 through November 30 would carry the 3% rate.

(2) If the billing includes only service on or after November 1, 1971, the 4% rate applies. For example: A billing for service from November 1 through November 30 would carry the 4% rate.

Tax S&U 112 Sales of building material, supplies or equipment.

A. In general. Under Minn. Stat. § 297A.01, subd. 4, sales of building materials, supplies and equipment to owners, contractors, subcontractors or builders constitute retail sales and are thus taxable.

The term "building materials, supplies and equipment", as used in these regulations, refers to property intended to become part of a new building, structure, road or an addition, repair, improvement or alteration to roads or real estate. A partial list of such materials includes gravel, blacktop, bricks,

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cement, steel beams and rods, electrical supplies, glass, woodwork, paint and paint supplies, pipes and valves, aluminum sheathing, wood and composition sheathing, lumber, plastics, roofing and wallboards. Other property usually incorporated into a building or other types of real property includes lighting fixtures, plumbing and bathroom fixtures, furnaces, boilers and heating units for space heating, pre-fabricated cabinets and central air conditioning units (for space cooling).

The term "real property" includes structures that are permanently affixed to real estate, such as buildings, fixtures, machinery, fences, railroad tracks, grain elevators, bridges, storage bins, silos, outdoor advertising signs, and billboards.

Other types of equipment may be incorporated into a new structure or added to an existing structure undergoing repairs, alterations or improvements in order to enhance the attractiveness of the structure or to increase its rental or sales value. Examples of such equipment are built-in dishwashers, stoves and ranges, garbage disposal units and air-conditioners installed in openings in outer walls.

B. Contractors and construction activities. Contractors are generally classified into two broad groups: general contractors and subcontractors.

A general contractor is a person who contracts to furnish the necessary materials and labor for the performance of a construction contract, and generally is one who contracts to build the entire project or a major portion thereof, or who contracts to install special building equipment, or who repairs or remodels a limited area in a structure at a price that includes machinery, equipment and installation charges. The person for whom the general contractor performs the work is generally the owner.

A subcontractor is a person who contracts to furnish the necessary materials and labor for the completion of a portion of the general construction contract at the job site. The subcontractor ordinarily contracts with the general contractor to perform a certain part of the work which the general contractor has undertaken to perform under the general construction contract.

The terms "contractor" and "subcontractor" are not applicable to persons who merely sell tangible personal property in the form of building materials, supplies or equipment to construction contractors, for delivery at the job site without any requirement that they install such tangible personal property.

The term "construction contract" as used herein refers to a contract under the terms of which a contractor agrees to perform construction activities resulting in an alteration, repair, or improvement of real property. Where machinery or equipment is attached to real property in such a manner and with the intent that it becomes a nontemporary accession to the real property, the contract pursuant to which it is attached shall be regarded as a "construction contract." Any attachment of property by or for a lessor thereof to realty not owned by the lessor where the lessor retains title and ownership of the

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of the property shall be considered a temporary accession to the real property and such property therefore retains its character as tangible personal property.

The term "construction contract" shall not include any contract for a sale of machinery or equipment which the seller, pursuant to the contract, will attach to or install upon real property if:

1. the machinery or equipment is of such size and installed in such a manner that it retains its character as personal property; or

2. the purchaser is not the owner of the real property to which the property will be attached, and the machinery or equipment can be removed without material injury to the realty; or

3. the title to the machinery or equipment passes from the seller to the purchaser prior to attachment to or installation on the real property.

Such construction activities do not include the sale and installation of an appliance, machinery, equipment or other item of tangible personal property in such a manner as not to become a permanent part of the real estate. Computers shall be considered to retain their classification and identification as personal property when installed because of such factors as industry standards, custom and practice, usage, and uniqueness. Where a fixed price or lump sum construction contract provides for the incidental transfer of certain tangible personal property and the contractor sells such items only as a part of the construction project, he is not regarded as a retailer provided that such personal property comprises an insubstantial portion of the total contract price.

Example 1. A dealer agrees to replace the old refrigerators with new models in a four-unit dwelling. The sale and installation of the refrigerators does not constitute a "construction contract". The tranaction represents a "sale at retail" to the owner of the four-unit dwelling.

Example 2. A computer manufacturer sells and leases computers and also installs them on the customer's property. The sale or lease of a computer, regardless of size, is a sale or lease of tangible personal property and the installation does not constitute a "construction contract."

Example 3. A leasing company purchases a piece of equipment from Company A and leases it to Company B. Company A installs the equipment on the property of Company B. The sale and installation of the equipment does not constitute a "construction contract," since the owner of the equipment is not the same as the owner of the property to which the equipment was installed. The equipment is considered to be tangible personal property and the leasing company purchases the property exempt for resale and collects the sales tax on the lease payments from Company B.

C. Construction contracts with exempt entities.

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1. The exemption from the tax on the sale of tangible personal property to the United States or to the State of Minnesota, and to other public agencies, as well as to corporations and other institutions exempt under the several clauses of Minn. Stat. § 297A.25, subd. 1, does not extend to building materials, supplies and equipment purchased by a contractor under an agreement to erect a building or to alter, repair or improve real estate for such exempt entity. However, purchases of such building materials, supplies and equipment by exempt entities are exempt from the sales and use tax.

Example. Village enters into a contract with Contractor for storm sewer construction. Contractor purchases materials for this job from various suppliers. The construction is clearly an alteration or improvement to real property with material purchased by contractor for use in constructing the storm sewer. These transactions constitute sales at retail and are subject to the sales tax. The contractual relationship between Contractor and Village does not affect the validity of the sales tax imposed upon Contractor. Had Village undertaken such construction with its own employees, the purchase of the materials by Village would not have been subject to tax.

2. Where an exempt entity has entered into a fixed-price construction contract which covers the complete structure including the materials, and the exempt entity furnishes some or all of the materials to the contractor for a credit against the contract price, a taxable sale occurs when the exempt entity transfers the materials to the contractor.

Example. School District enters into a contract with Contractor for the construction of a school building. Contractor not only specified the price at which he agreed to deliver the completed school, but made known to School District the portion of the total cost of construction allocated to building materials and supplies. In addition, Contractor furnished School District with the names of the several suppliers and the descriptions and price of each item or items furnished by each of such suppliers. Thereafter, School District purchased the specified items at the price furnished by Contractor and made payments from its own funds to the suppliers. The material and supplies so purchased were thereafter delivered to Contractor and, in return, School District received credit against the contract price for the payments made by it.

Although the initial purchase of the material and supplies by School District is not taxable, the transfer to Contractor is a "transfer of title or possession" and taxable as such for the following reason: Contractor has agreed to deliver a completed structure which necessarily includes the materials; during construction of the building the materials will be in the possession of Contractor, who bears the risk of any loss of such materials during construction; and a portion of the contract price is correspondingly reduced by the cost of the materials paid to the supplier by the School District.

3. The transfer of building materials by an exempt entity to its contractor for use in connection with a contract for the erection, alteration, repair or improvement of realty is not deemed a retail sale (and is thus exempt from the sales or use tax) provided: (1) the contract is for labor only; (2) all inci-

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dents of ownership to the building materials remain in the exempt entity at all times; (3) the contractor bears no responsibility for inherent defects in the building materials; and (4) the contractor bears no risk of loss of any of the building materials.

An exempt entity, in addition to contracting with a contractor for the erection of a building or the alteration or repair of real estate, may appoint and designate the contractor as "purchasing agent" for such exempt entity in connection with the construction contract. In such situations the department will recognize the agency relationship asserted only if the written contract clearly sets forth: (1) that such appointment has been made; (2) that title to all materials and supplies purchased pursuant to such appointment shall immediately vest in the owner or principal at point of delivery; (3) that the risk of loss with respect to such materials and supplies is that of the owner or principal; and (4) that the owner or principal, and not the agent, shall have responsibility for all defective materials and supplies, including those incorporated into realty purchased in such manner. In the event that the contract in question does not specify as to risk of loss, other competent evidence, such as insurance coverage, will suffice.

Any contractor who has been appointed agent for the purchase of materials and supplies, as specified above, shall furnish adequate notification to all vendors and suppliers of such agency relationship and shall make it clear to such vendors that the obligation for payment is that of the owner and not the contractor-agent. All purchase orders and other documents furnished to the vendor shall clearly reflect the agency relationship.

D. Contractor-retailer. A contractor-retailer is a person using building materials, supplies and equipment in the performance of his construction contracts, and in addition, is engaged in making "sales at retail" of building materials, supplies and equipment.

A sale by a contractor-retailer of building supplies, materials and equipment which sales does not provide for installation of the merchandise sold is a sale at retail.

A sale by a contractor-retailer of building supplies, materials and equipment which sale provides for installation of the merchandise is a construction contract and tax shall be paid by the contractor-retailer based upon his cost of materials. Two separate contracts executed contemporaneously by a contractor-retailer providing individually for the sale and installation of building materials, supplies and equipment shall be considered to be a single unified construction contract if that was the intent of the parties as evidenced by their actions. A contractor-retailer who enters into a construction contract with an exempt entity shall pay tax based upon his cost of materials.

A contractor-retailer sells property under both of the following two circumstances:

1. When he sells certain property without providing for installation, the

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sale constitutes a sale at retail. For example, the sale by a plumbing contractor of a water heater without installation is a sale at retail.

2. When a contractor-retailer sells certain property either installed or without installation, at the purchasers' option, and such property is sold with installation which causes it to become incorporated as a part of the realty, that sale shall be regarded as a construction contract and tax shall be paid by the contractor-retailer upon his cost of materials. For the purposes of such a transaction, retailer is deemed to be a contractor and his purchase of the supplies and equipment used in installing the property constitutes a retail sale to him.

Persons primarily engaged in the making of retail sales of building materials, supplies and equipment used in construction, alteration, repair or improvement of real property, and who are also engaged as contractors in building, altering, repairing or improving real property, shall report and pay their sales or use tax liability in accordance with the following:

If at the time such person makes a purchase of specific items and he knows the use to which such items are to be put, he shall either:

furnish an exemption certificate if such items are being acquired for the purpose of resale; or

pay the sales tax to the seller if the items in question are to be used by such person in the construction, alteration, repair or improvement of real property.

If at the time such person makes a purchase of certain items where he does not know the precise utilization of such items, and if his business activities during the prior calendar year reflect that fifty percent or less of such purchases were sold at retail, then he shall pay the sales tax to his supplier on all such purchases. If he later sells any of such items at retail, he may take a proper deduction on his sales and use tax return.

If his business activities during the prior calendar year reflect that more than fifty percent of such purchases were sold at retail, he may use a resale exemption certificate for the purchase of all such items. The resale exemption certificate shall contain the purchaser's name, address, sales and use tax account number and description of material to be purchased. In addition, the certificate must be signed and contain the following:

> "I HEREBY CERTIFY: That I am a contractor-retailer engaged in the making of retail sales and also the construction, alteration, repair or improvement of real property and that I am reporting and paying my sales and use tax liability directly to the Commissioner of Revenue."

A vendor receiving a resale exemption certificate with the above notation thereon is relieved from the responsibility of collecting the tax, and the bur-

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den will be upon the purchaser to demonstrate that he comes within the provisions of this regulation.

The accounting records of a contractor-retailer must clearly reflect the use made of items purchased for both the preceding and current calendar year. These records should be in such form that the Commissioner may determine readily that the proper sales and use tax liability is being reported and paid.

Example 1. In March, 1972, contractor-retailer purchased ten bathtubs at $150.00 each and twenty bathroom sinks at $40.00 each. As he was primarily a contractor, he paid the sales tax due thereon. During this same month, he sold at retail two bathtubs at $200.00 each and five bathroom sinks at $55.00 each. He reports gross receipts from sales at retail of $675.00. The sales tax due and owing from him is $27.00 (4% of $675.00). Since he is entitled to offset the tax paid by him on the property sold at retail, he makes the following calculation on Form ST-1 (Sales and Use Tax Return) filed by him for the month of March, 1972:

Line 1	Gross sales	$675.00
Line 2	Deductions (see line 19)*	$500.00
Line 3	Net Sales	$175.00
Line 4	Purchases subject to use tax	$ -0-
Line 5	Total taxable amount	$175.00
Line 6	Total tax due	$ 7.00

*Line 2 is calculated as follows:

Cost of goods sold:

2 bathtubs at $150.00 each	$300.00
5 bathroom sinks at $40.00 each	$200.00
Total cost of goods sold	$500.00

A supplementary schedule reflecting the above calculations should be submitted with the return.

Example 2. Contractor-retailer purchased ten bathtubs at $150.00 each and twenty bathroom sinks at $40.00 each. As he was primarily a retailer, he paid no tax at time of purchase, but gave his supplier an exemption certificate. Thereafter, in March 1972, he sold at retail two bathtubs at $200.00 each and five bathroom sinks at $55.00 each. In addition, he utilized three bathtubs and six bathroom sinks in his contracting activities. Contractor-retailer makes the following calculation on Form ST-1 (Sales and Use Tax Return) filed by him for the month of March, 1972. (For purposes of this example, it is assumed that in March, 1972 no other sales were made at retail and no other material, etc., were used in contracting activities):

Line 1	Gross sales	$ 675.00
Line 2	Deductions	$ -0-
Line 3	Net sales	$ 675.00

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Line 4 Purchases subject to use tax*	$ 690.00
Line 5 Total taxable amount	$1,365.00
Line 6 Total tax due	$ 54.60

*Line 4 is calculated as follows:

3 bathtubs purchased at $150.00 each	$ 450.00
6 bathroom sinks purchased at $40.00 each	$ 240.00
Total	$ 690.00

A supplementary schedule reflecting the above calculations should be submitted with the return.

E. Status of construction contracts on effective date of law. Where a contractor has entered into a fixed price or lump sum construction contract prior to June 2, 1967 (the first day after enactment of the Sales and Use Tax Law), which does not provide for payment of future taxes, the sale of building materials, supplies, etc., to such contractor will not result in a "retail sale" or "sale at retail" subject to the provisions of the Sales and Use Tax Law provided:

(1) The building material, supplies, etc., were delivered to the contractor; or

(2) The building material, supplies, etc., were identified by serial number or some other appropriate symbol, and segregated or set aside as the property sold by virtue of such contract; and

(3) If either event stated in 1 or 2 above occurred prior to June 2, 1968.

Example: Contractor signs a lump sum contract with Realty Company on April 15, 1967 whereby Contractor agrees to erect an office building for Realty Company. Contract did not contain a provision for reimbursement of future taxes. Contractor places the following orders: concrete for the foundation; steel for the framework; aluminum sheets for the outer covering, and stainless steel doors for the main entrance.

Delivery of the concrete and steel for the framework was effected before May 15, 1968. The aluminum sheets were produced by the manufacturer, and after being properly identified on May 25, 1968 for the Realty Company building, were stored until July 15, 1968, and then delivered to the construction site. As a result of a backlog of orders, the manufacturer could not produce the stainless steel doors until September 1, 1968, although the order had been placed many months earlier.

The sale to Contractor of the concrete and steel framework constitutes a non-taxable transaction as the contract was entered into prior to June 2, 1967 and all subsequent events with respect to these sales occurred prior to June 2, 1968.

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The sale to Contractor of the aluminum sheets constitutes a non-taxable transaction, as the conditions specified in (2) and (3), above, were satisfied.

The sale to Contractor of the stainless steel doors constitutes a "retail sale" or "sale at retail" subject to sales tax, as the conditions specified above were not satisfied.

In order to avail himself of the exemption from sales tax when a lump sum or fixed fee construction contract entered into prior to June 2, 1967 ("pre-tax contract") is involved, a contractor is required to file a copy of the contract, together with Form ST-7, at the offices of the Sales and Use Tax Divisions. Thereafter, the application will be reviewed and, if approved, an exemption will be granted to the contractor.

The exemption will be in the form of a certificate bearing an identifying number, and issued to the contractor. Such a certificate exempts only those building materials, supplies and equipment purchased for incorporation into the structure for which the exemption was granted.

Where a contractor has entered into more than one such pre-tax contract, he must submit a copy of the contract, and a copy of Form ST-7 for each contract for which an exemption certificate is requested.

Where a general contractor retains subcontractors to perform part of the work incident to a pre-tax contract, and the general contractor has received an exemption certificate, the exemption from tax extends to building material, supplies and equipment purchased by such subcontractor. The subcontractor may submit a photostatic copy of the general contractor's exemption certificate to the vendor.

F. The 3% rate of tax shall be applicable to sales of tangible personal property purchased for use in performing any written fixed-price or lump sum construction contract which was enforceable prior to November 1, 1971, which makes no provision for allocation of future taxes and which unconditionally vests the rights and obligations of the parties thereto, provided the delivery of such tangible personal property is made prior to November 2, 1972.

A construction contract shall be considered enforceable prior to November 1, 1971, even though signed after October 31, 1971, if it is executed pursuant to a bid which could not be withdrawn as of October 31, 1971, without payment of penalty.

Tangible personal property used in performing a construction contract as described herein shall include all materials and equipment which become incorporated as part of the improvement to realty and any other tangible personal property purchased for and used and fully consumed in performing such contract. It shall also include any equipment rented solely for use in performance of such a contract.

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Tax S&U 113 Use. Section 297A.01, Subd. 6, defines "Use" as the exercise of any right or power over tangible personal property purchased from a retailer incident to the ownership of any interest in that property, but it does not include the sale of such property in the regular course of business. "Use" does not include storing personal property to be used in the ordinary course of an owner's trade or business where such personal property is subsequently shipped or delivered to an ultimate destination outside Minnesota without being put to intermediate use in this state and thereafter not returned to Minnesota except in the course of interstate commerce. (As used herein, the term "intermediate use" does not include processing, fabricating or manufacturing into or incorporating into other tangible personal property or testing or modifying tangible personal property but includes consuming or enjoying the beneficial use of the property.)

Example 1. "X" Company purchases 100 typewriters from an outstate vendor for delivery to its main office in Minnesota. Thereafter, sixty typewriters are put to use in offices in its several Minnesota locations, while the remaining forty are placed in its Minnesota storage center. Subsequently, thirty of the remaining typewriters are shipped to "X" Company's several offices outside Minnesota and the ten typewriters remaining are assigned to Minnesota offices. Consequently, "use" does not include the thirty typewriters shipped to ultimate destinations outside Minnesota.

Example 2. Same facts as in Example 1 except that five of the typewriters assigned to Minnesota are subsequently shipped outside Minnesota after being used in this state for a period of time. Employing these five typewriters in Minnesota constitutes "intermediate use". (See Section 297A.14 regarding the imposition of the use tax with respect to property used in Minnesota.)

Tax S&U 114 Temporary storate and use in Minnesota. Where tangible personal property or tickets of admission to places of amusement or athletic events are shipped or brought into Minnesota for the purpose of subsequently being transported outside Minnesota, and such items are not intended to be returned to Minnesota except in the course of interstate commerce, definitions of "storage and use" (see Section 297A.01, Subd. 5 and 6, respectively) are not applicable thereto.

Similarly, where tangible personal property is shipped or brought into Minnesota for the purpose of being processed, fabricated or manufactured into other tangible personal property, or is incorporated or attached to other tangible personal property, and thereafter transported outside Minnesota, and such property is not intended to be returned to Minnesota except in the course of interstate commerce, the definitions of storage and use are not applicable thereto.

Example 1. "A" purchases four tickets from the University of Minnesota's athletic ticket office for a football game to be played at Madison, Wisconsin between the University of Minnesota and the University of Wisconsin. As such tickets were shipped into Minnesota for the purpose of subsequently being used outside Minnesota and in fact must so be used or wasted, "A"'s

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exercise of right or power over these tickets does not constitute either storage or use as defined in Section 297A.01, Subd. 5 or 6, respectively.

Example 2. "Z" Corporation purchased equipment in Wisconsin and requested that the vendor deliver the property to "Z" in Minnesota for inspection and testing. Upon completion of the tests on the equipment, which proved to be satisfactory, the equipment was shipped to "Z" factory in California. The testing and inspecting of the equipment in Minnesota does not constitute either storage or use as defined in Section 297A.01, Subd. 5 or 6, respectively.

Tax S&U 115 Reduction in sales price for property taken in trade. Excluded from the sales price is any amount allowed as a credit for tangible personal property taken in trade for resale. The payoff of the old contract does not affect the amount allowed on the trade-in; even if this indebtedness is included in the new contract. The property so accepted will qualify for the exclusion from the sales price provided both the following conditions are met:

Such property is taxable under the Sales and Use Tax Law or the Motor Vehicle Excise Tax Law.

Such property is of a type normally sold in the regular course of such retailer's business.

Example 1. Dealer sells a new boat with a list price of $3,000.00 to Customer. Dealer accepts Customer's used boat in trade and gives Customer a credit of $1,000.00 therefor. As the conditions above are met, the credit qualifies for the exclusion. Consequently, the "sales price" is $2,000.00.

Example 2. Farm Implement Dealer sells a combine to Farmer with a list price of $4,000.00 and accepts in trade a used cornpicker for which a credit of $300.00 is given. As the conditions above are met, the credit qualifies for the exclusion. Consequently, the "sales prices" is $3,700.00.

Example 3. Implement and Livestock Dealer sells a new tractor with a list price of $2,000.00 and accepts in trade three steers for which a credit of $750.00 is given. Although the second condition above is met, the first condition is not as steers sold by a livestock dealer are not taxable property. Consequently, the "sales price" of the tractor is $2,000.00.

Example 4. Jeweler sells a diamond ring to Customer for $2,000.00 and accepts in trade a new lady's fur coat for which a credit of $2,000.00 is given. Although the first condition is met, the second condition is not met as Jeweler does not engage in the sale of fur coats in the regular course of his business. Consequently, the "sales price" of the diamond ring is $2,000.00.

Example 5. Mobile home dealer sells customer a new mobile home with a list price of $12,000. The customer trades in his old mobile home which has an existing loan of $2,000 on it. The dealer agrees to include the payoff amount of the old contract in the new contract. The dealer allows $5,000 for

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the trade-in of the customer's mobile home. The following represents the amount of financing the customer arranges for and the "sales price" is $7,000:

List price	$12,000
Less: Trade In	5,000
Sales Price	7,000
Add: Payoff of old contract	2,000
New contract	$ 9,000

Tax S&U 116 Deductions not allowable in computing sales price. No exclusion of deduction is allowable in computing the "sales price" for the expenses described in A., B., C. and D. below.

A. Cost of the property sold and cost of transportation incurred prior to sale. As a general rule, the cost of the property sold includes all costs incurred in acquiring the property, and any related expenses necessary to transport it to the location where it normally will be sold.

Example 1. Interior Decorator recommends furniture for Customer's living room. Customer agrees to pay $3,000.00 to Interior Decorator for the articles recommended. Interior Decorator thereafter orders furnishings from a manufacturer at a cost of $1,800.00. No exclusion or deduction for cost of the property is allowed; consequently, the "sales price" is $3,000.00.

Example 2. Implement Dealer sells new farm tractor to Customer for $8,000.00. Included in the price is a charge of $150.00 representing transportation costs from the factory to Dealer. As no exclusion or deduction for cost of transportation incurred prior to sale is allowed, the "sales price" is $8,000.00. See Tax S&U 117(c) regarding transportation expense incurred after sale is consummated.

Example 3. Lumber dealer sells a carload of lumber to a building contractor at an agreed upon price of $8,000 including the cost of transportation. The lumber is to be ordered and drop-shipped directly to the purchaser. No exclusion or deduction for cost of transportation is allowed even if the purchaser pays the transportation charges directly to the common carrier and deducts the same from the amount due the seller. The delivered price is the "sales price."

B. Cost of material used–labor or service cost. Certain tangible personal property purchased at retail may require either additional material or additional labor or service, in order to be suitable for the purpose for which purchased, or because of a special request made by a customer. The charges for such labor or material may be included in the sale price or may be in addition thereto, depending upon the policy of the retailer or upon the nature of the property purchased and of the modifications required.

Example 1. Customer orders fur coat from Furs, Inc. for $800.00 which includes extensive alterations to be made in accordance with Customer's instructions. The cost of such alterations to Furs, Inc. is $100.00. As no

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exclusion or deduction for the labor or material involved in the alterations is allowed, the "sales price" is $800.00.

Example 2. TV Dealer sells Customer a color television receiver for $700.00 installed. The installation and adjustments are performed by a service company which charges TV Dealer $15.00. No exclusion or deduction for installation or adjustment labor involved is allowed since such charge is not separately stated. Consequently, the "sales price" is $700.00.

Example 3. Customer orders watch from Jeweler for $250.00 and requests that initials be inscribed in diamond chips. Jeweler agrees to do so without charge for labor but charges Customer $50.00 for the diamond chips used. As no exclusion or deduction is allowed for cost of materials used, the "sales price" is $300.00.

C. Interest. Interest paid by vendors or lessors to their creditors for borrowed funds used in the conduct of the business may not be deducted in determining the "sales price" subject to tax.

Example. Lessor and Lessee enter into an agreement whereby Lessor will lease ten new 1968 trucks to Lessee at $2,000.00 per year per truck. The effective date of the lease contract is January 1, 1968. Lessor finances the purchase of the trucks through Bank. The interest paid to Bank in 1968 by Lessor is $4,000.00. No part of this interest paid is allowable as an exclusion or deduction from the lease payments required to be paid by Lessee. Consequently, the "sales price" of the retail sale represented by the lease for the year 1968 is $20,000.00 (10 X $2,000.00).

D. Discounts. In computing "sales price", the total consideration for the sale shall not be reduced by the discount allowed where the amount of the discount is determined by events that occur subsequent to consummation of the sale.

For example, Dealer sells a TV set to Customer for $500.00 on credit on January 15, 1969. May 1, 1969, Customer complains about the high price. Dealer grants a reduction of $50.00 in sales price as a discount. This discount will not be allowed as a deduction. Sales tax is computed on $500.00.

Tax S&U 117 Deductions allowable in computing sales price. The following charges or expenses in connection with a sale are allowable as deductions provided the amounts attributable to such charges are reasonable under the circumstances and are stated separately on the invoices submitted to the purchaser or consumer.

A. Interest on unpaid balance–carrying or finance charge. A material proportion of sales made at retail are made on a credit basis, particularly where the property sold is classified as durable consumers goods. Purchases of such items as automobiles, refrigerators, furniture or jewelry are financed by means of periodic payments, usually on a monthly basis. Consequently, each

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payment may contain three elements: (1) interest on the unpaid balance; (2) carrying or finance charges; and, (3) payments to be applied against the unpaid balance.

Example 1. Boat Dealer sells a new Boat to Customer for $3,000.00. Customer agrees to pay $100.00 per month for 36 months, representing $450.00 interest at five percent for three years and $150.00 for collision, fire and theft insurance. Each payment made to Boat Dealer represents the following: $83.33 on unpaid balance; $12.50 for interest; and $4.17 for the insurance coverage. (Adjustments may be made for the fractional cents.) Consequently, the amount required to be reported by Boat Dealer when payment of $100.00 is made is $83.33 if he is on the cash basis. If he is on accrual basis, $3,000.00 is reportable at time of sale.

Example 2. Same facts as in Example 1 except that Boat Dealer, who is on the cash basis, discounts Customer's note at his bank before any payments are made by Customer and received $2,970.00. Boat Dealer thereafter is required to report the "sales price" of $3,000.00 for the month in which the note was discounted at his bank.

Example 3. Department Store sells various household furnishings and appliances to Consumer for $1,000.00. Consumer agrees to pay six percent interest plus two percent finance and service charges on the unpaid balance and further agrees to pay $100.00 per month. First payment was made one month after sale was consummated. The $100.00 is allocated as follows:

	Payment	Principal	Interest & Finance & Carrying Charges	Balance
First Month	$100.00	$93.33	$6.67	$906.67
Second Month	100.00	93.96	6.04	812.71
Third Month	100.00	94.58	5.42	718.13

If Department Store is on the cash basis, it will report $93.33, $93.96 and $94.58 for the first three months, respectively. If Department Store is on the accrual basis, it will report $1,000.00 in the month the sale is made.

B. Installation charges for labor and services. Tangible personal property may be sold either uninstalled or installed. The labor or service charge for the installation is allowable as a deduction arriving at "sales price", provided such charge is stated separately on the invoice and such installation charge is not a device for reducing the "selling price" materially below the normal price at which the property involved in the transaction is usually sold.

Example 1. Retailer advertises a free-standing kitchen range for $250.00 without installation, and $266.00 installed. Customer orders the range installed. Retailer's bill reflects a sale of a kitchen range for $250.00 and installation charges of $16.00. Consequently, the "sales price" is $250.00.

Example 2. Tire Shop sells Customer a new tire for $40.00 and replaces

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the old tire with a new one. The bill reads: 1 New Super Deluxe Tire–$40.00. As labor or service charges for mounting the new tire are not stated separately, the "sales price" is $40.00.

C. Transportation charges incurred after sale. The right to exclude transportation charges from the "sales price" refers to transportation occurring after the retail sale has been consummated, provided that such charges are stated separately on the invoice, and also provided that where the price at the place of sale is the same as the price delivered, no reduction from the total consideration paid shall be allowed in arriving at the "sales price".

For purposes of the Sales and Use Tax Law, the particular terms of delivery of property sold at retail are immaterial in determining the amount of sales price subject to tax. All separately stated charges for transportation from the premises of retailers to their customers billed to the customers by retailers are deemed to occur after such retail sales have been consummated.

Example 1. Department Store sells suite of living room furniture to Customer for $1,000.00. Policy of Department Store, as expressed in advertisements, is to deliver all merchandise purchased by customers free within a radius of 25 miles, provided the sales prive of the merchandise delivered is in excess of $100.00. Although cost of delivering the suite of living room furniture is $25.00, no reduction in "sales price" will be allowed as the implication was the Customer, who was within the 25-mile limits, would not be obligated to bear the cost of transportation.

Example 2. Building Supplier sells insulation at $3.00 per bag, cash and carry. Customer requires fifty bags but asks that merchandise be delivered and agrees to pay delivery charges. Building Supplier delivers merchandise with his own truck and then bills Customer as follows:

50 bags insulation at $3.00 per bag	$150.00
Shipping charges	20.00
Total	$170.00

Example 3. Same as 2 but the invoice reads as follows:

50 bags insulation at $2.50 per bag	$125.00
Shipping charges	45.00
Total	$170.00

The "sales price" will be deemed to be $150.00 in both the above examples as the $3.00 price is the cash and carry price offered to customers at vendor's place of business.

D. Discounts. Discounts on sales are of three kinds: trade, quantity and cash. A trade discount is a deduction from the list or gross price for the purpose of arriving at the selling price, and generally is not recorded in the accounting records.

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Quantity discounts are basically trade discounts. They are increased with the size of the purchase as an inducement to the customer to buy in large quantities. For example, list price—$150.00 less 30% if purchased in quantities of five or more units. Selling price is $105.00.

Cash discounts are those granted to credit customers as an inducement to pay the account early. Such cash discounts or "sales discounts", as they are commonly called, are stated in such terms as 2/10, n/30. The credit terms 2/10, n/30 mean that a two percent discount may be subtracted from the amount owed if paid within ten days from the sales invoice date; otherwise, the full amount is due within thirty days from date of sales invoice.

Example. Customer purchases a typewriter for $200.00. Terms are 2/10, n/30. Customer pays on the ninth day following receipt of invoice, and deducts the cash discount of $4.00. The "sales price" is $196.00.

Vendors usually account for sales under the "gross sales" method, that is, by reflecting in sales the full amount of the sales price without any deduction for the discount to be given the purchaser for early payment. Under this method, sales discounts earned are treated as a reduction in the amount of gross receipts to be reported for the period in which such discounts are taken. Certain vendors use the "net sales" method in accounting for sales. Under this method, the vendor assumes that all his customers will avail themselves of the discount allowed for early payment. Subsequently, if a customer fails to pay within the prescribed period and remits the full sales price (without deduction for the sales discount), the additional amount is credited to a descriptive account, for example, Sales Discounts Forfeited. The total amount of discounts so forfeited shall be credited to gross receipts for the reporting period in which received.

Example. Retailer uses "net sales" method of accounting for sales discounts. Sales for September (all subject to 2%—10 day discount) are $20,000.00. Retailer's books reflect the following summary:

Accounts Receivable	$19,600.00	
Sales		$19,600.00

Included in this total are sales of $4,900.00 derived from gross sales of $5,000.00 on which the ten-day discount period does not end prior to October. The gross receipts reportable are $19,600.00.

In the following month of October, Retailer receives $3,920.00 (representing $4,000.00 in gross sales for which payment was made timely) and $1,000.00 (representing $1,000.00 in gross sales where discount was forfeited).

The books reflect the following summary in respect of these transactions:

Cash	$ 4,920.00	
Accounts Receivable		$ 4,900.00
Sales Discounts Forfeited		20.00

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The $20.00 of Sales Discounts Forfeited are required to be included in the gross receipts reportable for October.

E. Refunds for property adjustments. Where taxable property is returned, the retailer's gross receipts may be reduced in the month the property is returned by the amount of the sales price refunded, provided that the applicable sales tax has also been refunded. If the credit given for the returned merchandise is reduced by a handling charge, the entire amount of sales tax collected should be refunded and a reduction of gross sales for the full sales price should be taken on the sales and use tax return. Where a purchaser of taxable property makes a gift of such property, and subsequently the recipient of the gift returns the property to the vendor and requests a refund of the amount paid for the property, the recipient is entitled to a refund of the sales tax applicable to the amount of the sales price that is refunded. Repossession of tangible personal property does not constitute a return of property. Merchandise that was sold "on approval" and later returned may be deducted from gross receipts.

Adjustments to the sales price because of unknown damage at the time of sale, i.e. scratches, dents, etc., but not detected until a later time, may be deducted from gross receipts.

For property returned prior to March 22, 1973, a reduction in gross receipts is allowable only if the property was returned within three months of the date of purchase.

Example 1. Hardware Dealer sells Customer a lawnmower for $100.00 on May 1, 1972. Customer pays $100.00 plus $4.00 sales tax. As lawnmower was defective, it was returned to Hardware Dealer on May 10, 1972 and $104.00 was refunded to Customer. Gross receipts will be reduced by $100.00.

Example 2. Retail Tires sells four new tires to Customer at $40.00 each under guarantee on June 1, 1972. August 15, 1972, Customer returns one tire and is given a cash refund of $30.00 plus $1.20 tax. Retail Tires may reduce gross sales by the $30.00 refunded on his August Sales and Use Tax Return.

Example 3. "A" purchases taxable personal property from Retailer at a price of $100.00. "A" pays Retailer $104.00 or ($100.00 sales price, plus $4.00 sales tax). "A" then makes a gift of the property to "B". "B" returns the property to Retailer and requests a refund of the amount paid for the property. "B" (the donee of the gift) is entitled to a refund of $104.00 ($100.00 sales price, plus $4.00 sales tax). The Retailer may reduce gross sales by $100.00 on his sales tax return for merchandise returned and thereby received credit for the amount of refundment.

Example 4. Lumber Company sells 20 redwood posts to a customer for $100.00. A $4.00 sales tax is charged and collected. The customer decides not to use the posts and returns them to Lumber Company. Lumber Company has a policy of refunding all but $10.00 on all returned merchandise.

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This $10.00 represents a handling fee for placing the merchandise back into stock. Lumber Company is required to refund the customer the entire $4.00 sales tax and claim a reduction of $100.00 gross sales on its sales and use tax return.

F. Taxes imposed by United States. The sales price shall be reduced by any tax imposed by the United States upon or with respect to retail sales, whether imposed upon retailers or consumers. This deduction does not apply to manufacturers' or importers' excise taxes.

Custom duties paid by a purchaser to the United States are not part of the consideration paid for retail sales and are thus, not includible in the sales price.

Example 1. Local telephone exchange service charge is $5.70 plus U.S. excise tax of $ .57. Only the $5.70 is subject to Minnesota sales tax, since the federal excise tax is imposed upon the consumer. The total charge will thus be $5.70 plus 4% of $5.70 (i.e. $ .23) plus the federal tax, $ .57, or a total of $6.50.

Example 2. Retailer sells Brand X tires for $28.00 plus applicable taxes. Federal manufacturers' excise tax is $2.32. Minnesota sales tax is 4% of $30.32 ($28.00 plus $2.32) or $1.21. Gross receipts reportable by Retailer in respect of this transaction are $30.32.

Example 3. Retailer purchases a camera for $500.00 in Europe and is required to pay a customs duty of $37.50 thereon at the time of entry in the United States. The use tax due is 4% of the $500.00 sales price of the retail sale, or $20.00.

Tax S&U 118 Gross receipts defined—method of reporting.

(a) Gross receipts. The sales tax is imposed upon the "gross receipts" from sales at retail. "Gross receipts" are herein defined as the total amount received in money or otherwise for all sales at retail (see Section 297A.01, Subd. 4) as measured by the "sales price." (See Section 297A.01, Subd. 8.)

The person filing the return may report his gross receipts either:

(1) On the cash basis as the consideration is received; or

(2) On the accrual basis as sales are made.

An election will be deemed to have been made to report gross receipts under the method of accounting on the basis of which the person filing the return regularly computes his income for tax purposes, unless he can demonstrate to the Commissioner that a method of accounting for gross receipts subject to the sales tax (which differs from the method of accounting employed by him for other purposes) will not prevent or make difficult an

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orderly and systematic audit of his records by the Commissioner. An application shall be made to the Commissioner for permission to change the method of reporting.

(b) Cash basis. Where sales are made at retail on a strictly cash basis, the vendor shall report his gross receipts on the basis of cash or other consideration received, minus the exclusions and deductions from the total consideration allowed under Sections 297A.01, Subd. 8, and 297A.25.

(c) Accrual basis. Where a person reports income on the accrual basis, he is required to report his gross receipts as the sales are made, minus the exclusions and deductions from the total consideration allowed under Sections 297A.01, Subd. 8 and 297A.25, regardless of when cash from such sales is received.

Example 1. Supermarket's gross sales for May, 1968, are $200,000, of which $175,000 are represented by exempt products. In addition, cash refunds of $1,000 for exempt products returned were made. The computation for Supermarket, which is on a cash basis, is as follows:

Gross receipts		$200,000
Less: refunds for property returned		1,000
Gross receipts adjusted		$199,000
Sales of exempt property	$175,000	
Less: refunds for exempt property returned	1,000	
		$174,000
Taxable gross receipts		$ 25,000

Example 2. Department Store has cash sales of $500,000 and charge sales of $750,000 for the month of October, 1968. Department Store reports on the accrual basis. Consequently, Department Store reports as gross sales $1,250,000 on the Sales and Use Tax Return it files for this month.

Tax S&U 119 Retailer. A retailer is any person engaged in making "sales at retail". A "sale at retail" or a "retail sale" as defined in Section 297A.01, Subd. 4, means a sale for any purpose other than resale in the regular course of business. Under Section 297A.01, Subd. 3, a sale includes any one of a number of transactions not ordinarily considered to be retail activities. Consequently, the person making such a sale is deemed to be a retailer in accordance with Section 297A.01, Subd. 10, and this regulation.

For illustrative purposes, a partial listing of retailers follows:

A person who leases automobiles, trucks, trailers or tractors;

A person who leases office equipment or computers;

A person who leases machinery, heavy earth-moving equipment or any other type of tangible personal property;

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A person who installs a truck body on a new chassis for a consumer;

A person who binds printed sheets furnished by a consumer;

A person who prints on paper stock furnished by a consumer;

A person who furnishes, prepares or serves food, meals or drinks to a customer for a consideration (see Section 297A.01, Subd. 3(c), for exceptions);

A person who grants the privilege of admission to a motion picture theater or any other place of amusement or recreation for a consideration, including plays, concerts, bowling alleys, golf courses, state or county fairs, professional or amateur athletic contests, skating rinks, etc.;

A person who furnishes music through mechanical devices such as juke boxes for a consideration;

A person who operates a hotel, rooming house, tourist court, motel or trailer camp, or who leases real property for lodging purposes for a period of less than thirty days (see Section 297A.01, Subd. 3(e));

A person who furnishes, for a consideration, electricity, gas, water, steam or local exchange telephone service, or instrastate toll telephone service;

A person who sells or furnishes any type of tangible personal property or service constituting a sale other than a sale for resale as defined in Section 297A.01; and

A person who machines castings, threads pipes or processes lumber for customers who have furnished the material.

Tax S&U 120 Agricultural production. Under the provisions of Section 297A.01, Subd. 13, the term "agricultural production" (as used in Section 297A.25, Subd. 1(h) includes the terms "horticulture", "floriculture", "raising of pets, fur-bearing animals, research animals, and horses".

Agriculture is the art or science of cultivating the ground, especially in fields or in large quantities, including the preservation of the soil, the planting of seeds, the raising and harvesting of crops, and the rearing, feeding and management of livestock; tillage, husbandry; farming.

Horticulture is the cultivation of a garden or an orchard–the science of growing fruits and vegetables and flowers or ornamental plants.

Floriculture is the cultivation of ornamental flowering plants.

The above activities, for the purpose of the Sales and Use Tax Law are agricultural production to the extent that the "person" as defined in Section 297A.01, Subd. 2, commercially engages in the activities so described, or if the product of such activities is on a scale comparable with that of a commer-

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cial producer. The agricultural activity must result in the production of personal property intended to be sold ultimately at retail.

The following examples are illustrative:

(1) Homeowner grows a few vegetables and flowers in his back yard for his own use. This activity does not constitute agricultural production. Consequently, no exemption is allowed for seeds, fertilizers, etc., purchased by homeowner.

(2) "A" keeps two pedigreed cocker spaniels as show dogs. Each litter of pups born to the female is sold by "A". As "A" is not regularly engaged on a commercial scale in the breeding and raising of such dogs, no exemption for feeds or other items used is allowed.

(3) "Z" raises white mice, hamsters and other animals which he sells to various laboratories, research institutions and hospitals. The animals so sold are used for experimental purposes. Although "Z" devotes only part of his time to this activity, nevertheless breeding and raising of these animals is for commercial purposes and is deemed to be agricultural production.

(4) Kennel boards dogs and also raises pedigreed dogs for sale to the public. Materials, chemicals, fuels, feeds, electricity, etc., used in raising the animals held for sale are exempt. The materials and other items used for the purpose of caring for dogs boarded at the kennel are taxable.

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CHAPTER TWO: Tax S&U 200-299
ADMINISTRATION OF THE SALES TAX

Tax S&U 200 Imposition of sales tax. The measure of the tax imposed upon the seller is 4% of the gross receipts of such person from sales made at retail after October 31, 1971, except that in the case of sales made at retail through coin-operated vending machines, the tax imposed upon the seller shall be 3% of the gross receipts from sales of taxable items. Vending machines are any coin-operated devices dispensing food, drinks, tangible personal property or providing amusement.

With respect to sales made after October 31, 1971, the "actual tax collected method" may not be used by the seller to reduce his liability to an amount less than that computed on the basis of gross receipts, as set forth in this regulation.

Tax S&U 201 Advertising tax will be absorbed—misdemeanor. Under Section 297A.03, Subd. 2, it shall be unlawful for any retailer to advertise or hold out or state to the public or to any customer, either directly or indirectly, that the tax imposed by the Sales and Use Tax Law will be absorbed or assumed by such retailer, or that the tax will not be added to the sales price, or that, if added, such amount or any part thereof will be refunded to the purchaser.

Example: Advertised or marked price of a taxable item is $99.99. When the sale is made, the seller will collect $99.99 plus four percent sales tax ($4.00), or a total of $103.99. The seller, if he so chooses, can advertise the item as $99.99 plus tax" or as "$99.99 plus $4.00 tax," or as "$103.99 including Minnesota sales tax."

In the computation of the amount of tax to be collected on any transaction, amounts of less than 1/2 cent may be disregarded and the amounts of 1/2 cent or more shall be considered as an additional cent. Thus, on a sale of 12 cents or less, the purchaser pays no tax; on a sale between 13 cents to and including 37 cents, he is required to pay one cent tax; on a sale between 38 cents to and including 62 cents, he is required to pay two cents tax; on a sale between 63 cents to and including 87 cents, he is required to pay three cents tax; on a sale of 88 cents to and including $1.12, he is required to pay four cents tax; on a sale in excess of $1.00, he is required to pay four percent on each full dollar plus the appropriate amount from the brackets above.

Tax S&U 202 Application for permit to make retail sales.

A. In general. Generally, the tax imposed by the Sales and Use Tax Law is required to be collected by the seller and subsequently remitted to the Commissioner in accordance with the provisions of the Sales and Use Tax Law. Minn. Stat. § 297A.04 requires that any person, as defined in Minn. Stat. § 297A.01, subd. 2, who is engaged in making retail sales or is engaged in other activities taxable under the Sales and Use Tax Law, shall obtain a sales and

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use tax permit from the Commissioner. Such a person includes not only a seller located in Minnesota, but also a seller located outside Minnesota who is authorized to do business within Minnesota, or who is authorized under Minn. Stat. § 297A.15 to collect the tax upon all transactions taxable under the Sales and Use Tax Law.

B. Non-taxable retail activities. Where a person engages in retail activities exclusively non-taxable, he is not required to apply for or secure a permit.

Example 1. "F" engages in the sale of poultry and eggs at his farmhouse. He engages in no other retail activities. As such food products are exempt under Minn. Stat. § 297A.25, subd. 1, "F" is not required to secure a sales and use tax permit.

Example 2. Bakery engages in sales of bakery goods for consumption off its premises. Since such food products are exempt, Bakery is not required to secure a sales and use tax permit.

C. Multiple locations. Where a person who is required to secure a permit has more than one place of business wherein he engages in activities subject to tax under the Sales and Use Tax Law, and he elects to file a separate return for each place of business, he is required to file a separate application for each such business location. He will thereafter receive a permit which may be used only at the address indicated therein. A separate permit will be assigned to each such place of business. Members of a group of corporations related by stock ownership, where such members are engaged in making sales at retail, are required to make individual applications.

In the event a person elects to file a consolidated return, he is required to submit to the Commissioner a list containing the business name and address of each separate place of business. In such event, the applicant need submit but one application to the Commissioner. (However, see clause F. of this regulation regarding the payment of permit fees where the election to file a consolidated return is made.) Thereafter, he will receive a permit for each location with the appropriate information contained therein. Each of such permits will bear the same sales and use tax account number. If, thereafter, he elects to file a separate return for one or more of his places of business, a new account number should be secured for the business location for which such separate return is filed. See Tax S&U 203 regarding application for new permits.

D. Vending machines. Where the person required to secure a sales and use tax permit operates vending machines in more than one location, he shall not be required to secure a separate permit for each such location. Vending machines include but are not limited to coin-operated machines that dispense soft drinks, coffee, tea, milk, candy bars, sandwiches, soups, and items of tangible personal property such as combs, hair dressings, etc. Included in this definition are coin-operated devices providing amusement and diversion. These devices are commonly referred to as juke boxes, pinball machines, shuffleboards, etc.

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Example. "V" operates fifty coffee and soft drink vending machines at various locations. He is required to secure only a single permit.

E. Information required. Application for a permit shall contain the following information:

1. The legal form of organization; that is, individual, partnership, Minnesota corporation, foreign corporation, association, etc.;

2. Date when taxable sales were first made or date when taxable sales are expected to begin;

3. Name and mailing address to which sales tax forms are to be sent;

4. Minnesota Tax Department Identification Number, unless no such number was previously assigned;

5. Business name and location or appropriate name and location;

6. If there are two or more locations, and the consolidated method is elected each business name and address;

7. The date on which the fiscal year ends;

8. List of owners, partners or principal officers and home addresses and social security numbers of such individuals;

9. Type of business; e.g., retail trade, wholesale trade, manufacturing, motion picture theater, hotel, bowling alley, dance hall, etc.; and

10. Whether business is operated seasonally and, if so, usual opening and closing dates.

Such applications shall be signed by the owner, if a natural person, by a partner if the applicant is a partnership, or by a person authorized to sign if the applicant is a corporation or an association.

F. Fee. At the time of making an application, the applicant shall pay the Commissioner a fee of $1.00 for each permit applied for. Where the applicant elects to file a consolidated return as provided in clause C. above, he is required to pay a $1.00 permit fee for each location.

Where there is a change in ownership or name, the following rules are applicable:

1. Sale of a business enterprise operated as a sole proprietorship requires a new application and payment of the $1.00 fee, although the business may be continued under the same name.

2. Admission of a new partner or resignation, expulsion or death of a

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partner requires a new application and payment of the $1.00 fee, although the business may be continued under the same name.

3. A change in the ownership of shares of stock of a corporation does not invalidate a permit issued to the corporation, as there has been no shifting of the liability for payment of sales and use tax.

4. A change in name of a business enterprise or a change in location, where there has been no change in ownership, requires the issuance of a permit reflecting the changed name or address. As no application is required by law, the permit holder will be issued the corrected permit upon request. As a matter of policy, the old permit should accompany the request. Payment of the $1.00 fee is not required.

5. In the event of the death of a permit holder who was operating a business as a sole proprietor, the duly appointed and qualified estate representative of the decedent's estate can assume and use the decedent's Minnesota Sales and Use Tax Account Number during the period of probate administration. However, if the decedent's business is sold or ownership is assumed by a member of the decedent's family, a change of ownership occurs and a new Minnesota Sales and Use Tax Permit is required.

Tax S&U 203 Permit when valid and how displayed. Generally, after the applicant has complied with the provisions of Sections 297A.04 and 297A.05, the Commissioner will issue a separate permit for each place of business for which application was made unless the Commissioner, in order to assure compliance with the Sales and Use Tax Law, deems it necessary for the applicant to deposit security. (See Section 297A.28.) In that event, the Commissioner will issue the permits requested at the time the applicant has complied with the additional provisions regarding the security requested.

The permit issued shall be valid until revoked in accordance with Section 297A.07, and shall not be assignable. Such permit shall be valid only for use by the person in whose name it is issued and for the transaction of business at the place designated therein. Thus, where there has been a change of ownership, so that the liability for payment of the sales and use tax is shifted either wholly or in part, or where there has been a change in name or in location of the business enterprise, the permit is no longer valid. In such cases, the permit holder must apply for a new permit. The procedures for securing a permit described in Sections 297A.04, .05 and .06 are applicable where there has been a change in ownership. Where there has been a change in name or in the business location without a change in ownership, a new permit containing the changed name or address will be issued without charge upon return of the permit previously issued.

Example 1. "P", a sole proprietor, applies for and is issued a permit under the business name of Modern Tobacco Shop. Subsequently, "P" sells the business to "Q" who continues the business activities under the same trade name. The permit previously issued to "P" is no longer valid as there has been a shift

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in the liability for payment of the sales and use tax from "P" to "Q". An application for a new permit plus the $1.00 fee is required to be submitted.

Example 2. "A" and "B", as partners, apply for and are issued a permit under the business name of Downtown Jewelry Store. Subsequently, "C" is admitted as a partner. The business name and the location remain the same. The permit previously issued to "A" and "B", as partners, is no longer valid as the admission of "C" as a partner resulted in a shift of the liability for the sales and use tax. An application for a new permit, plus the $1.00 fee is required to be submitted.

Example 3. "X", "Y" and "Z", between themselves, own 100 percent of the stock of Building Materials, Inc. A permit is applied for and issued in the corporate name. Subsequently, "X" sells all of his stock to "Z". The permit holder, Building Materials, Inc., continues to transact business at the same location and under the same name. The permit previously issued is still valid as the liability for payment of the sales and use tax, which was previously imposed upon the corporate entity at the time the permit was issued, remains.

Example 4. A permit was applied for and issued in the name of General Trading Company, Inc. Subsequently, the name is changed to General Discount Corporation. The permit issued to the General Trading Company is no longer valid as a permit "shall be valid only for the person in whose name it is issued." A new permit will be issued without charge upon return of the permit issued to General Trading Company, Inc.

Example 5. A permit was applied for and issued in the name of John Jones, 100 Main Street, Anytown, Minnesota. Subsequently, John Jones moves his quarters across the street to 115 Main Street. As a permit shall be valid only "for the transaction of business at the place designated therein," a new permit containing the new address will be issued without charge upon return of the old permit.

Where a permit holder is primarily engaged in taxable activities which require him to shift his location from place to place, such change in location shall not be deemed to be a change of address. However, such permit holder, upon filing his sales and use tax return at the time required to do so under Section 297A.27, shall include a list of the locations at which he transacted business during the period in question and the dates applicable to each such location. In the event such permit holder engages in taxable activities in two or more dispersed locations within the same general area, he may display his permit at one location and photocopies of such permit at his other locations.

Example 1. A concessionaire at the State Fair Grounds during State Fair week who operates several concessions may display his original permit at one location and photocopies thereof at his other locations.

Example 2. A permit was applied for and issued to the Deluxe Carnival Company, whose permanent office is 250 Main Street, Anytown, Florida. The carnival moves from town to town in Minnesota and sets up its tents and

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equipment in lots temporarily rented. The permit granted to the Deluxe Carnival Company is valid, and must be displayed at each temporary location.

A permit issued by the Commissioner shall at all times be conspicuously displayed. A permit revoked by the Commissioner shall be surrendered to the Commissioner immediately upon notice of revocation. (See Section 297A.08 regarding penalties for engaging in retail sales without the required permit or permits.)

Tax S&U 204 Revocation of permits. The permit or permits issued to any person, hereinafter referred to as the Permit Holder, under Sections 297A.04, .05 and .06, may be revoked or suspended by the Commissioner if the Permit Holder fails to comply with any of the provisions of the Sales and Use Tax Law.

The Commissioner shall not revoke or suspend the Permit Holder's permit or permits prior to granting him a hearing. Such hearing shall not be held unless the Commissioner has served notice in writing at least thirty (30) days prior to the date for such hearing. The Commissioner may serve personal notice upon the Permit Holder or he may make such service by mail. (Special Session Laws 1967, Chapter 48, Section 96, permits the Commissioner of Revenue to serve notice by regular mail in all cases if he deems the use of regular mail advisable.) Such hearing shall be conducted by a Hearing Examiner appointed by the Chief Hearing Examiner pursuant to the Administrative Procedures Act, Laws of 1975, Chapter 380. The hearing shall be held at the time and place specified in the Notice of Hearing.

An official record of the testimony and exhibits presented at the hearing shall be prepared by the hearing examiner. If the Permit Holder wishes to secure a transcript of the procedures, such transcript will be available from the Office of the Hearing Examiner upon payment of the fee prescribed by the hearing examiner.

The hearing examiner will submit to the Commissioner his findings and conclusions. The final decision of the Commissioner will not be made until the report of the hearing examiner has been made available to parties to the proceeding for at least 10 days and an opportunity has been afforded to each party adversely affected to file exceptions and present arguments to the Commissioner.

If the Commissioner with reasonable cause after the hearing either revokes or suspends the permit or permits of the Permit Holder, the latter may submit a new application in accordance with Minn. Stat. §§ 297A.04, .05 and .06. Such application shall be accompanied by reasonable evidence that the Permit Holder intends to comply with the provisions of the sections of the law or the regulations which he had previously violated. Under Minn. Stat. § 297A.07, the Commissioner may request that the Permit Holder deposit any security in addition to that authorized by Minn. Stat. § Section 297A.28 that the Commissioner deems reasonably necessary in order to insure compliance by the Permit Holder.

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An alternative procedure is available to the Permit Holder. He may appeal the Commissioner's order revoking or suspending his permit or permits to the Minnesota Tax Court in accordance with Minnesota Statutes, Chapter 271.

Tax S&U 205 Retail sales without permit—violation. Any person required under the provisions of Section 297A.04 to apply for a permit and who fails to do so, or whose application for a permit has been denied, or whose permit has been either revoked or suspended by the Commissioner without subsequent reinstatement shall be guilty of a misdemeanor if he engages in the business of making sales at retail. Under Section 297A.01, Subd. 4, a retail sale is defined as "a sale for any purpose other than resale in the regular course of business." Where the vendor engages in the business of making retail sales in Minnesota without the required permit as a corporation, each officer of such corporation shall be guilty of a misdemeanor.

Such misdemeanor charge shall be brought before the municipal court having jurisdiction to hear, try and determine violations subject to misdemeanor charges in the city, village or borough where the retail sale without permit was made.

Where a vendor is engaged in making sales at retail at more than one location without the necessary permit or permits, separate misdemeanor charges may be brought before each municipal court having jurisdiction.

Tax S&U 206 Presumption that tax must be paid. Under Section 297A.02, the gross receipts of a retailer are subject to the sales tax of four percent. Section 297A.09 provides that all gross receipts are presumed to be subject to tax unless the contrary is established. Under this section, the burden of proving that a sale was not a sale at retail is upon the seller.

The presumption that a sale is a sale at retail may be overcome if the seller accepts and retains for his records an exemption certificate given to him, by the purchaser, stating that the property so purchased is for resale.

Under Section 297A.10, the exemption certificate will conclusively relieve the retailer from collecting and remitting the tax only if taken in good faith from a person who holds a permit.

The presumption that all gross receipts are subject to tax may be overcome if the seller accepts from the purchaser an exemption certificate to the effect that the property purchased is exempt under Section 297A.25, Subd. 1(h) or (i), as materials used or consumed in agricultural or industrial production of personal property intended to be sold ultimately at retail, or as tangible personal property used or consumed in, or which becomes a part of, any publication regularly issued at intervals not exceeding three months. An exemption certificate so accepted will relieve the retailer from collecting and remitting the tax only if taken in good faith.

The presumption that all gross receipts are subject to tax may be overcome

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if the seller accepts from the purchaser an exemption certificate to the effect that such purchaser is exempt from paying the tax under the Sales and Use Tax Law.

The presumption that all gross receipts are subject to tax may be overcome if the seller accepts from the purchaser an exemption certificate stating that the purchaser has been granted a Direct Pay Permit.

Tax S&U 207 Good faith acceptance of exemption certificates. In general, Minn. Stat. § 297A.09 creates a presumption that all gross receipts are subject to tax, but permits the seller to accept exemption certificates to the effect that the property was purchased for resale, or that the sale is otherwise exempt under the Sales and Use Tax Law.

A. Where a sale is made to a person claiming to purchase the property for resale, the presumption that the sale is subject to tax, will be conclusively overcome only if the retailer accepts a Resale Exemption Certificate in good faith from the purchaser. Although the seller is under no duty to ascertain beyond all reasonable doubt that the purchaser is acquiring the property for resale, the provision that he act in good faith requires the seller to exercise reasonable care and judgment before accepting the Resale Exemption Certificate. The good faith provision requires that the seller accept only certificates meeting the requirements of Minn. Stat. § 297A.11.

Example 1. Supplier sells to retail customers at list, and to automotive repairmen at 60% of list. He receives an order for a new generator from an automobile garage operator with whom he has had no prior transactions. The generator, which has a list price of $25.00, is sold, after routine investigation, to the automobile garage operator for $15.00 (60% of list). The sale to the automobile garage operator at the discount price indicates that the Resale Exemption Certificate offered by the purchaser was taken in good faith. Consequently, the supplier will be conclusively relieved of the duties of collecting and remitting the tax otherwise due on the sale. Had supplier sold the generator at the list price of $25.00, he would not be conclusively relieved of the duty of collecting and remitting the tax due thereon even though he had accepted a Resale Exemption Certificate.

Example 2. Jeweler orders a living room set from a distributor of furniture and offers a Resale Exemption Certificate which states that Jeweler is engaged in the business of selling jewelry at retail. Since the Resale Exemption Certificate does not indicate that the Jeweler is in the business of selling furniture at retail, the distributor is not conclusively relieved of the duty of collecting and remitting the tax due on the sale of such living room furniture.

Example 3. Lumber dealer receives an order for a quantity of lumber accompanied by a Resale Exemption Certificate. Customer specifies delivery to a construction site. Under such circumstances, lumber dealer could not properly claim good faith acceptance of the Resale Exemption Certificate. Without further investigation establishing that the lumber is intended to be resold, he would not be relieved of the burden of collecting and remitting the sales tax.

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B. Where a sale is made to a person claiming that the property purchased will be used or consumed in agricultural or industrial production, or used or consumed in the production of any publication regularly issued at average intervals not exceeding three months, the presumption that the sale is subject to tax will be conclusively overcome where the retailer takes a Certificate of Exemption in good faith from the purchaser. The seller will be deemed to have exercised good faith provided he is aware of the type of business activity conducted by the purchaser, and provided the property claimed to be exempt is of a character normally used or consumed in the production process carried on by the purchaser. The seller is under no duty to ascertain whether the property so purchased is, in fact, actually used for the exempt purpose.

Minn. Stat. § 297A.25, subds. 1(h) and (i), specifically state that machinery, equipment, implements, tools, accessories, appliances, contrivances and furniture and fixtures used in such production or publication, and fuel, electricity, gas or steam used for space heating or lighting are not included in the exemption. Consequently, the retailer or supplier could not, in good faith, accept a Certificate of Exemption for sales of those items since they are subject to tax.

Example. "M", manufacturer, orders ten gross of screws used in producing kitchen cabinets which are ultimately to be sold at retail. In addition, he orders a drill press from the same vendor. "M" had previously given "V", vendor, a blanket Certificate of Exemption relating to materials used or consumed in industrial production. The blanket exemption certificate will be applicable to the sale of screws. As machinery and equipment used in production are not exempt, "V" is required to collect a sales tax on the drill press.

C. Vendors may accept the following in good faith:

1. Certificates of Exemption claiming exemption of purchases of railroad rolling stock and parts necessary for the maintenance and repair of such rolling stock, where such certificates are taken from railroad companies, freight line companies, sleeping car companies and express companies which state thereon that they are subject to tax on a gross earnings basis in lieu of ad valorem taxation.

2. Certificates of Exemption claiming exemption on purchases of airflight equipment, and flight simulators and parts necessary for the repair and maintenance of such equipment, where such certificates are taken from persons who state thereon that they are taxed under the provisions of Minn. Stat. §§ 270.017 to 270.079, inclusive.

3. Certificate of Exemption claiming exemption on purchases of telephone central office telephone equipment which state thereon that such property will be used in furnishing intrastate and interstate telephone service to the public.

4. Certificates of Exemption claiming exemption on purchases of mill

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liners, grinding rods and grinding balls where such certificates are taken from persons who state thereon that they are taxed under the in lieu provisions of Minn. Stat. ch. 298, and where such certificates state that such property will be substantially consumed in the production of taconite, while becoming a part of the material produced.

5. Certificates of Exemption claiming exemption on purchases of property which will be shipped or transported outside Minnesota by the purchaser without any intermediate use, which will be used in a trade or business outside Minnesota, and which state thereon that the property will not be returned to Minnesota except in the course of interstate commerce.

6. Certificate of Exemption claiming exemption on purchases of packing materials used to pack and ship household goods to destinations outside Minnesota and which will not be returned to Minnesota except in the course of interstate commerce.

7. Certificates of Exemption which state thereon that the materials purchased are on purchases of materials designed to advertise and promote the sale of merchandise or services, which material is purchased and stored for the purpose of subsequently shipping or otherwise transferring outside the state by the purchaser for use thereafter solely outside the State of Minnesota.

D. Where a sale of tangible personal property is made to an organization that is organized and operated exclusively for religious or educational purposes, the seller will be relieved from the duty of collecting and remitting the tax otherwise due on the sale if he receives a Certificate of Exemption from the organization stating to that effect, and provided that he is reasonably certain that the purchaser is a religous or educational organization entitled to the exemption. Thus, although the seller is not obligated to investigate to determine whether the purchaser is entitled to the exemption, the seller, either from past experience or from his own general personal knowledge of the community and its affairs, should, in most cases, be able to determine whether the purchaser is the type of organization it claims to be. For example, the various schools and churches in any community are well-known and, consequently, a seller would be "reasonably certain" that such a school or church making purchases of tangible personal property is entitled to exemption.

Organizations claiming exemption as charitable organizations must establish their right to such exemption by making application to the Commissioner of Revenue for a Certificate of Exempt Status on Form ST-16. Such an application may also be made by religious and educational organizations wishing to obtain a Certificate of Exempt Status as a convenience to themselves and their suppliers. A Certificate of Exempt Status, Form ST-17, will be issued after the application and supporting documents are examined and approved. The Certificate of Exempt Status will bear an E. S. number and the signature of an authorized official of the Department of Revenue. An organization holding a Certificate of Exempt Status may reproduce the certificate as neces-

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sary to be furnished to its suppliers. A seller of tangible personal property may accept a copy of a Certificate of Exempt Status in good faith from the organization to which it was issued.

Refer to TAX S&U 415 regarding criteria for determining whether or not organizations qualify for exemption as charitable, religious or educational.

As described above, the Certificate of Exemption or Certificate of Exempt Status is valid for purchases made on behalf of the exempt organization, but not for purchases made for the personal use of persons affiliated with or employed by the exempt organization. The seller may be reasonably certain that such is the case if he either bills the organization for the sales price, delivers the property to the location of the organization, or accepts payment by means of a check frawn by the organization, either at the time of purchase or subsequently.

Refer to clause F. below regarding meals, admissions and lodging.

E. Where a sale of tangible personal property is made to the United States, its agencies, its instrumentalities, a state, its agencies, its instrumentalities or its political subdivisions, the sale is exempt. The seller will be relieved of the duty of collecting and remitting the tax otherwise due on such property by accepting an authorized purchase order, payment voucher on other document clearly showing that the purchaser is a governmental unit.

Refer to clause F. below regarding meals, admissions and lodging.

F. Although the furnishing of meals, admissions or lodging is defined as a taxable sale by Minn. Stat. § 297A.01, subd. 3(c), it is not a sale of tangible personal property and, thus, is not within the exemptions described in clauses D. and E. above for sales of tangible personal property to governmental, charitable, religious and educational organizations in Minn. Stat. § 297A.25, subd. 1(j) and (p). Accordingly, a Certificate of Exemption, Certificate of Exempt Status or governmental purchase order may not be accepted in good faith for such a sale, except in the case of sales directory to the United States Government. Refer to TAX S&U 410 for details.

G. A seller is not required to collect and remit the tax on sales of tangible personal property which he delivers to a common carrier for delivery to an outstate destination, or places the property in the United States mail or parcel post directed to a purchaser outstate, or delivers the property to a purchaser outstate by means of the seller's own delivery vehicles. No exemption certificate is required under these circumstances. However, adequate evidence of shipment or delivery to the out-of-state destination must be maintained by the seller.

Tax S&U 208 Content and form of exemption certificate.

A. In General. Minn. Stat. § 297A.09 provides for the furnishing of ex-

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emption certificates with respect to exempt sales. Vendors accepting exemption certificates which do not include the following five elements of a valid certificate shall not be deemed to have accepted an exemption certificate in good faith. Exemption Certificates must contain the following information:

1. Name and address of the purchaser.

2. The account number of the permit issued to the purchaser, or, if no number, state reason.

3. The general character of the property sold by the purchaser in the regular course of business.

4. Description of the property purchased.

5. Signature of the purchaser.

The Commissioner has approved use of the following certificates to assist purchasers in claiming exemption.

ST-3 is to be used for claiming exemption for any of the reasons listed on the certificate.

ST-4 is to be used for claiming a percentage exemption for fuels and energy utilized in industrial or agricultural production.

ST-5 is to be used for claiming exemption on property purchased for resale in substantially unchanged form or acquired for leasing or subleasing.

ST-17 is to be used by the exempt organization to which it is issued for claiming exemption on purchases of tangible personal property.

UNIFORM SALES TAX EXEMPTION CERTIFICATE designed by the Multistate Tax Commission.

These certificates may be used for single purchases or for continuing future purchases. When used in this latter manner, the certificate is referred to as a blanket exemption certificate. Whether a certificate is a single purchase or blanket certificate is determined by marking the appropriate blank provided in the form except for the Uniform Sales Tax Exemption Certificate which does not contain such a blank but may be used as either a single purchase or a blanket certificate.

The Commissioner does not furnish exemption certificates in bulk. In order to assist purchasers in preparing their own copies, the forms approved by the Commissioner are reproduced as follows:

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Form ST-3
(Rev. 1-1-74)

Minnesota Department of Revenue
Sales and Use Tax Division
CERTIFICATE OF EXEMPTION

I, the undersigned purchaser, hereby certify that I am engaged in the business of_____
(Describe nature of business activity)

and that the tangible personal property described herein which I shall purchase, lease or rent from

Name of Seller

Address

is exempt for the following reason:

☐ The purchaser is an organization organized and operated exclusively for educational or religious purposes.

☐ The property is intended for use or consumption in agricultural or industrial production of property intended to be sold ultimately at retail. This exemption does not pertain to machinery, equipment, implements, tools (except qualifying detachable accessory tools), accessories, appliances, contrivances, furniture and fixtures, neither does it apply to purchases exceeding $100,000 in any calendar year of paper and ink products by a publisher for use in an exempt publication.

☐ The property will be shipped or transported outside Minnesota by the purchaser without any intermediate use, will be used in a trade or business outside Minnesota, and will not be returned to Minnesota except in the course of interstate commerce. This exemption includes packing materials used to pack and ship household goods to destinations outside Minnesota, and material designed to advertise and promote the sale of merchandise or services, which material is purchased and stored for the purpose of subsequently shipping or otherwise transferring outside the state by the purchaser for use thereafter solely outside the state of Minnesota.

☐ The property is rolling stock purchased by a railroad, taconite railroad, freight line, sleeping car or express company, taxed on gross earning under Minnesota Statutes, Chapters 294 and 295. Rolling stock includes engines, cars, tenders, coaches, sleeping cars and parts necessary for the repair and maintenance of such rolling stock.

☐ The property is telephone central office telephone equipment used in furnishing intrastate and interstate telephone service to the public.

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☐ The property is mill liners, grinding rods, and grinding balls purchased by a company taxed under the in lieu provisions of Minnesota Statutes, Chapter 298, and is substantially consumed in the production of taconite, the material of which primarily is added to and becomes a part of the material being processed.

☐ The property is airflight equipment purchased by an airline company taxed under Minnesota Statutes, Sections 270.071 through 270.079. Air flight equipment includes airplanes and parts necessary for the repair and maintenance of such air flight equipment and flight stimulators.

Detailed description of property on which exemption is claimed: _____

_____

_____

Check applicable box: ☐ Single purchase certificate ☐ Blanket certificate

If blanket certificate is checked, this certificate continues in force until cancelled by the purchaser. If the purchaser uses the property described herein for other than exempt purposes and subsequently, with the intent to evade the tax, fails to file a sales or use tax return declaring the taxable use of such property, the purchaser will be subject to the full penalty of the law.

Purchaser's Business Name	Signature of Authorized Purchaser
Address	Title
City State Zip Code	Date

Purchaser's Sales and Use Tax Account Number	If no number, state reason _____

NOTE: Sellers must keep this certificate as a part of their records. Incomplete certificates cannot be accepted in good faith.

STOCK NO. 58

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Form ST-4

MINNESOTA DEPARTMENT OF REVENUE
FUELS AND ENERGY
EXEMPTION CERTIFICATE

☐ Blanket

☐ Unit

_____
Date of Purchase or Period Covered

The undersigned hereby claims tax exemption for the purchase of fuels, electricity, gas and/or steam described within and made under this certificate in the proportion so declared for exempt usage in agricultural or industrial production. The undersigned further agrees to pay the required tax upon the remainder of the purchase subject to the Minnesota Sales and Use Tax.

Percentage of Fuel or Energy Used for Exempt Purposes _____%

_____
Statement describing how percentage was determined

_____
Quantity and type of energy or fuel purchased

_____
Vendor's name and address

_____
Purchaser's name and address

_____ _____
Purchaser's Business Activity Purchaser's Sales & Use Tax Account No.

I hereby certify that the above statements are true, that all information given is accurate to the best of my knowledge and that I am duly authorized to sign this application.

_____ _____
Signature Date

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Form ST-5
((Rev. 2-1-74)

MINNESOTA DEPARTMENT OF REVENUE
SALES AND USE TAX DIVISION
RESALE EXEMPTION CERTIFICATE

I, the undersigned purchaser, hereby certify that I am engaged in the business of selling, leasing or renting _____

_____

(List items sold, leased or rented)

and that the tangible personal property described herein, which I shall purchase, lease or rent from

_____
Name of Seller

_____
Address

will be resold, leased or rented by me; provided, however, that if any such property is used for any purpose other than retention, demonstration or display while holding it for sale, lease or rental in the regular course of business, it is understood that I am required to report and pay the tax measured by the purchase price of such property.

Detailed description of property to be purchased for resale: _____

_____

_____

_____

Check applicable box: ☐ Single purchase certificate ☐ Blanket certificate

If blanket certificate is checked, this certificate continues in force until cancelled by the purchaser. If the purchaser uses the property described herein for other than exempt purposes and subsequently, with the intent to evade the tax, fails to file a sales or use tax return declaring the taxable use of such property, the purchaser will be subject t the full penalty of the law.

Purchaser's Business Name	Signature of Authorized Purchaser
Address	Title
City State Zip Code	Date

Purchaser's Sales and Use Tax Account Number	If no number, state reason _____

NOTE: Sellers must keep this certificate as a part of their records. Incomplete certificates cannot be accepted in good faith.

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Effective July 1, 1969, no exemption for purchases by an organization purporting to be engaged in exclusively charitable activities shall be allowed unless the organization claiming exempt status has applied for a special exemption certificate issued by the Commissioner. See Tax S&U 415, pertinent to exemptions for charitable organizations for facsimile of Form ST-17, Certificate of Exempt Status to be used subsequent to June 30, 1969.

B. Special exemption certificates. Special exemption certificates for claiming specific exemptions are, also, issued by the Commissioner to persons who qualify upon application. Special exemption certificates in current use are Form ST-14, Direct Pay Permit, and Form ST-14mc, Motor Carrier Direct Pay Certificate. See Tax S&U 211 and 212 for facsimiles of these special exemption certificates.

Tax S&U 209 Non-exempt use of purchase obtained with exemption certificate. Under Sections 297A.09 and 297A.10, the seller may accept an exemption certificate from the purchaser on items otherwise taxable under the Sales and Use Tax Law. Under Section 297A.12, if such purchaser should thereafter make any use of the property for which he had given an exemption certificate other than for a purpose exempt under the Sales and Use Tax Law the use thereof shall be deemed a retail sale by the purchaser as of the time first used by him, and the sales price (see Section 297A.01, Subd. 8 regarding the calculation of sales price) shall be reported as purchases subject to use tax on the sales and use tax return.

Example 1. Retailer, engaged in making sales of TV sets, purchases ten TV sets at $500.00 each and gives a Resale Exemption Certificate to his supplier. Subsequently, he removes one TV set from stock for personal use in his home. This constitutes making use of the TV set for a purpose other than resale in the regular course of Retailer's business. Consequently, Retailer is required to include $500.00 as a purchase subject to use tax.

Example 2. Manufacturer of office equipment gives an exemption certificate for material used or consumed in the process of producing such equipment. Thereafter Manufacturer removes twenty desks from finished goods stock for use in his own offices. His accounting records disclose that the total cost of the material used in the production of the twenty desks was $1,000.00. As Manufacturer made use of the material other than for a purpose exempt under Section 297A.25, Subd. 1(h), Manufacturer is required to include in his purchases subject to use tax the retail price of the material used or consumed in manufacturing the desks, that is, $1,000.00. If Manufacturer is not engaged in the business of making sales at retail and consequently, has not made application for, or been issued a permit (see Section 297A.04 through 297A.06), he should report the purchases subject to use tax by filing a Consumer's Use Tax Return, Form UT-1, in such cases. These returns are available upon request to the Commissioner of Revenue, Department of Revenue, Centennial Office Building, Saint Paul, Minnesota 55145.

Tax S&U 210 Fungible goods for which exemption certificate given. Fungible goods are movable goods which may be estimated and replaced according to

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weight, measure and number. Such goods comprise those belonging to the same class that do not have to be dealt with in specie (retaining existence as a distinct individual "of a particular class"). Common examples of fungible goods are grain in silos or elevators, oil in tanks, coal in hoppers and lumber in piles.

If a purchaser gives an exemption certificate in respect of fungible goods as provided for by Sections 297A.09 and .10 and thereafter commingles these goods with other fungible goods not so purchased but of such similarity that the goods purchased under the exemption certificate cannot be distinguished from the other goods, sales from the mass of commingled goods shall be deemed to be sales of the goods purchased under the exemption certificate until all the non-taxable purchases have been accounted for.

Tax S&U 211 Direct Pay Permit procedure.

A. The Commissioner of Revenue may issue a Direct Pay Permit to certain persons who:

1. Purchase substantial amounts of tangible personal property for business use under circumstances that normally make it difficult or impractical at the time of purchase to determine whether such property will be subject to the sales tax or whether the use thereof will be exempt, and

2. Hold a sales and use tax permit.

The holder of a Direct Pay Permit shall report and pay the applicable use tax directly to the Commissioner instead of paying the sales tax to its vendors with respect to all materials purchased pursuant to such Direct Pay Permit.

B. An application for a Direct Pay Permit must be submitted to the Commissioner of Revenue. The application should be in the form of a letter containing the applicant's name, address, sales and use tax account number, description of the business, description of accounting system to reflect the proper amount of tax due, volume of purchases, and justification for adopting the direct pay method.

To qualify for a Direct Pay Permit, a business must demonstrate to the satisfaction of the Commissioner of Revenue that:

1. The nature of the businesss is such that the direct pay method will materially reduce the administrative work of collecting the tax;

2. The firm's accounting system will clearly reflect the proper amount of tax due; and

3. The firm makes taxable purchases in sufficient volume to justify the expense of regular audits by the Department of Revenue.

Each request for a Direct Pay Permit will be carefully reviewed, and each

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person whose application is accepted will receive a Direct Pay Permit which will be numbered, dated and signed by the Commissioner of Revenue or his delegated representative. The Commissioner of Revenue shall issue a Direct Pay Permit only in those cases in which, in his judgment, it is in the best interests of the State of Minnesota to do so.

C. The holder of a Direct Pay Permit shall furnish a copy of his Direct Pay Permit or a statement that he holds Direct Pay Permit number_____dated _____to each vendor from whom he purchases tangible personal property on which an exemption is claimed. This shall relieve the vendor from the responsibility of collecting the sales tax on purchases made by such permit holder. Each person issued a Direct Pay Permit must keep a current list of all vendors from whom purchases are made under the direct pay method, and, upon request by the Commissioner, shall submit such list for examination.

The holder of a Direct Pay Permit must either issue the permit to all vendors required to collect Minnesota sales and use taxes (except those excluded in (d) below), and accrue all liability as a use tax, or maintain accounting records in sufficient detail to show in summary, and in respect to each transaction, the amount of sales taxes paid to vendors in each reporting period.

If the holder of the permit chooses the latter alternative, then all purchases from any one supplier must be made either "exempt" or "taxable". It is not permissible to request the vendor to assess the sales tax on only selected transactions.

D. A holder of a Direct Pay Permit may never use it in connection with the following transactions:

1. Purchases of taxable food or beverages;

2. Purchases of taxable lodging or services related thereto;

3. Purchases of admissions to places of amusement or athletic events, or the privilege of use of amusement devices.

E. Direct Pay Permit is not transferable. The Commissioner may revoke a Direct Pay Permit at any time for failure to comply with the conditions under which such authority was granted or for any other reason constituting misuse of such authority. The Direct Pay Permit may also be revoked where the continued use thereof is determined by the Commissioner to be contrary to the best interests of the State of Minnesota.

F. A facsimile of the authorized Direct Pay Permit is reproduced as follows:

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State of Minnesota—Department of Revenue
Sales and Use Tax Division

DIRECT PAY PERMIT

This permit is not transferable

Permit Number D P
Date Issued
Sales & Use Tax Account Number

This permit constitutes authority to make direct payment of sales and use tax to the Commissioner of Revenue in lieu of payment to the vendor.

The Commissioner may revoke a Direct Pay Permit at any time for failure to comply with the conditions under which such authority was granted or for any other reason constituting misuse of such authority, and in cases where the continued use of such permit is found by the Commissioner to be not in the best interests of the State of Minnesota.

Commissioner of Revenue

By _____
Sales and Use Tax Division

ST-14

Tax S&U 212 Motor Carriers—Direct Pay.

A. Under Minn. Stat. § 297A.211 persons described in clause B. engaged in interstate for-hire transportation of property by motor vehicle may elect to pay sales and use taxes directly to the Commissioner of Revenue on mobile transportation equipment and parts and accessories attached or to be attached to such equipment. Electing carriers shall give notice of such election to the Commissioner of Revenue and shall pay taxes due in accordance with provisions of this regulation. Required notice shall be in the form of a letter setting forth the electing carrier's name, address, sales and use tax account number, and accompanied by the carrier's Certificate of Public Convenience and Necessity issued by the Interstate Commerce Commission or other evidence such as the file number issued by the Minnesota Public Service Commission to verify that it is a carrier engaged in transporting tangible personal property in interstate commerce.

B. For periods prior to April 7, 1977, "persons referred to in clause A. include only common carriers of tangible personal property and does not

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include carriers which possess permits as "contract carriers" issued by the Interstate Commerce Commission. Subsequent to April 6, 1977, "persons" referred to in clause A. include (1) persons possessing a certificate or permit authorizing for-hire transportation of property from the Interstate Commerce Commission or the Minnesota public service commission; (2) persons transporting commodities defined as "exempt" in for-hire transportation in interstate commerce; and (3) persons who, pursuant to contracts with persons described in clauses (1) or (2) above, transport tangible personal property in interstate commerce. Persons engaged solely in the transportation of passengers and their baggage do not come within the provisions of Minn. Stat. § 297A.211.

C. A Motor Carrier Direct Pay Certificate will be issued to qualified electing carriers by the Commissioner of Revenue and will be effective as of the date shown on the certificate. A facsimile of the authorized Motor Carrier Direct Pay Certificate is reproduced as follows:

Form ST-14mc

State of Minnesota
Department of Revenue—Sales and Use Tax Division
Centennial Office Building—St. Paul, Minnesota 55145

MOTOR CARRIER DIRECT PAY CERTIFICATE

Certificate No. MCDP
Effective Date
Sales and Use Tax Account Number

The holder of this certificate has elected to make direct payment of sales and use tax to the Commissioner of Revenue in lieu of payment to the vendor on purchases or leasing of interstate mobile transportation equipment and parts and accessories attached or to be attached to such equipment.

This certificate is not transferable and applies only to purchases or leasing of mobile transportation equipment to be used within and without Minnesota and parts and accessories attached or to be attached to such equipment.

Commissioner of Revenue

By _____
Sales and Use Tax Division

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D. Carriers which elect to pay the Minnesota Sales and Use Tax under the provisions of Minn. Stat. § 297A.211, shall be governed by the following:

1. They shall hold or must have applied for a Minnesota Sales and Use Tax Permit. Application for such a permit, Form MB-A, should accompany the carrier's notice of election if none had previously been applied for.

2. Sales and use taxes due on the purchases and leases of tangible personal property other than mobile transportation equipment and parts and accessories attached or to be attached thereto shall be paid directly to retailers authorized to collect the Minnesota tax at the same time and in the same manner as though no election had been made. Such property may not be purchased or leased exempt under a Motor Carrier Direct Pay Certificate.

3. Mobile transportation equipment intended for use both within and without Minnesota and parts and accessories attached or to be attached thereto may be purchased or leased tax free by presenting a copy of Motor Carrier Direct Pay Certificates to the seller.

A. "Mobile Transportation Equipment" includes trucks, tractors and trailers used in interstate transportation.

B. "Parts and Accessories attached or to be attached thereto" includes refrigeration equipment, tires, batteries, repair parts and any other property which is attached or affixed to such mobile transportation equipment.

C. Not included in "Mobile Transportation Equipment and Parts and Accessories attached or to be attached thereto" are equipment such as flashlights, flares, grease, oil, antifreeze, additives, containers used for packing and transporting customers' goods, dollies, pallets, hand trucks, fork-lift trucks, snowplows, local pickup and delivery vehicles, other warehouse and plant equipment, office supplies and equipment, etc.

4. Sales and Use Taxes due in respect of mobile transportation equipment and parts and accessories attached or to be attached thereto shall be paid directly to the Commissioner of Revenue by way of a return filed on or before the 25th day of the month following the purchase or rental of such property. Such return shall be made on Form ST-1, Sale and Use Tax Return. On line 4 of such return there shall be shown the sum of:

A. The sales price of items purchased or leased other than mobile transportation equipment and parts and accessories attached or to be attached thereto, which are subject to the use tax and upon which no sales or use tax has previously been paid; and,

B. An amount determined by multiplying the total cost of mobile transportation equipment and parts and accessories attached or to be attached thereto purchased or leased during the month by a fraction, the numerator of which is the road mileage operated during the past calendar

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year within Minnesota and the denominator of which is the total road mileage operated during the past calendar year. Mileage figures shall be based on records required to be maintained by the Interstate Commerce Commission. Persons qualifying for Motor Carrier Direct Pay Certificate who are not subject to I.C.C. regulations must, as a condition of qualification, maintain on a current basis the same type of mileage records that are required to be kept by persons subject to regulation by the I.C.C.

For purposes of the computation in b. above, "the total cost of mobile transportation equipment and parts and accessories attached or to be attached thereto" shall include the sales price of all such property purchased and the total payments for lease or rental (not including interchange between carriers) of such property for use in interstate commerce within or without Minnesota, irrespective of whether such property was physically present in Minnesota. Total road mileage operated during the past calendar year shall mean mileage operated by all such property including property which did not operate in Minnesota. For a new carrier without a prior year's mileage, an estimated ratio may be used subject to approval by the Commissioner.

5. Where sales or use tax has been paid to another state on an item which is includable in the Minnesota return, a credit is allowable for such tax (limited to the Minnesota sales and use tax rate) in the same ratio as the cost of the item is included in the Minnesota tax base.

6. Withdrawal of an election to come under the provisions of Minn. Stat. § 297A.211 shall become effective only upon notice of such intent and return of the Motor Carrier Direct Pay Certificate to the Commissioner of Revenue. If such election is withdrawn, subsequent re-relection shall be effective only upon approval of the Commissioner of Revenue. Common Motor Carriers which do not elect to pay Minnesota Sales and Use Tax under the provisions of Minn. Stat. § 297A.211, shall be governed by the following:

a. Prior to January 1, 1972, carriers shall pay the sales and use tax directly to registered retailers on all purchases of mobile transportation equipment, parts, accessories, equipment and supplies not exempt under the provisions of the Sales and Use Tax Law. If the retailer is not registered, the carrier shall pay the use tax directly to the Commissioner of Revenue.

b. Subsequent to December 31, 1971, "Mobile Transportation Equipment" subject to the motor vehicle excise tax under the provisions of Minn. Stat. ch. 297B, is not subject to the Minnesota Sales and Use Tax. A motor vehicle excise tax, equal to the sales and use tax rate, is collected at the time such equipment is registered in Minnesota. On purchases of parts, accessories, equipment and supplies, not exempt under provosions of the Sales and Use Tax Law, the carrier shall pay the sales and use tax directly to registered retailers. If the retailer is not registered, the carrier shall pay the use tax directly to the Commissioner of Revenue.

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CHAPTER THREE: Tax S&U 300-399
ADMINISTRATION OF THE USE TAX

Tax S&U 300 Imposition of use tax. The "use tax" is a compensating or complementary tax, reaching the use, storage or consumption of certain items purchased for use in Minnesota. The use tax is imposed at the rate of four percent of the sales price at retail unless the sales tax previously has been paid thereon.

The use tax shall be imposed in accordance with the applicable provisions of the Sales and Use Tax Law that are controlling with respect to the imposition of the sales tax.

Tax S&U 301 Liability for payment of use tax. Section 297A.15 imposes upon the purchaser of tangible personal property used, stored or consumed in Minnesota, liability for the use tax until the tax has been paid to Minnesota. However, where the purchaser can satisfy the Commissioner that the tax has been collected from the purchaser by a retailer who maintains a place of business in Minnesota, or by a retailer authorized by the Commissioner to collect the tax, the purchaser's liability for payment of the tax due is extinguished.

Under the due process clause of the United States Constitution, a seller neither authorized to do business in Minnesota nor maintaining a place of business in Minnesota, may not have imposed upon him an obligation to collect a use tax for the purpose of remitting such tax to Minnesota. Where such a seller indicates that he is willing to collect a use tax on tangible personal property sold to persons located in Minnesota, authorization to do so may be granted to him provided he agrees:

to collect the use tax due from his customers on storage, use or consumption in Minnesota of taxable personal property in accordance with Section 297A.16;

to file a Minnesota sales and use tax return for each month on or before the twenty-fifth day of the succeeding month (see Section 297A.26), and to remit to Minnesota the use tax so collected (see Section 297A.17); and

to maintain adequate records of all sales of taxable personal property made to persons within Minnesota.

Tax S&U 302 Collection of tax at time of sale. Any corporation authorized to do business in Minnesota (see Minn. Stat. ch. 303 for provisions regarding "foreign corporations" authorized to do business in Minnesota), any retailer maintaining a place of business in Minnesota, or any seller authorized to collect use tax under Minn. Stat. § 297A.15, upon making sales of taxable personal property for storage, use or consumption in Minnesota, where such items are not exempt in respect of the purchaser under the Sales and Use Tax

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Law, shall collect the use tax from the purchaser and give to such purchaser a receipt or other written or printed memorandum evidencing payment of the tax.

"Retailer maintaining a place of business in Minnesota" is defined for purposes of this regulation as any retailer having or maintaining within Minnesota an office, distribution house, sales house, warehouse, a manufacturer's representative, salesman, or any agent operating within this State under the authority of the retailer, whether such place of business or agent is located in Minnesota permanently or temporarily. Thus when a manufacturer's representative, salesman or agent takes an order for merchandise and forwards the order to the out-of-state vendor who fills the order, ships the merchanidse to the Minnesota purchaser and bills the customer for the merchandise, the out-of-state vendor is required to have a permit, collect the Minnesota use tax from the customer, and remit the tax to the State of Minnesota.

Outstate business making deliveries to Minnesota customers in its own trucks is responsible for the collection and remittance of the use tax imposed on Minnesota buyers.

When a manufacturer's representative takes the order and bills the purchaser and collects for the merchandise himself, he is then considered a vendor for purposes of administering the Minnesota Sales and Use Tax Law, and is required to have a permit and collect the sales tax from the customer.

Where such an out-of-state vendor does not have a Minnesota Sales and Use tax permit, any manufacturer's representative, salesman, agent or employee of such vendor, who sells, solicits orders for or delivers tangible personal property in this state for such vendors, is guilty of a misdemeanor which is punishable by a fine of not more than $100 for each offense, or by imprisonment for not more than 30 days or by both such fine and imprisonment.

Tax S&U 303 Unlawful to advertise that use tax will be absorbed. Section 297A.18 prohibits any retailer to advertise or hold out or state to the public or to any customer, either directly or indirectly, that the use tax imposed under Section 297A.14, will be absorbed or assumed by such retailer, or that such tax will not be added to the sales price, or that, if added, such amount, or any part thereof, will be refunded to the purchaser.

Example. The advertised or marked price of a taxable item is $99.99. When the sale is made, the seller will collect $99.99 plus four percent use tax ($4.00), a total of $103.99. The seller, if he so chooses, can advertise the item as "$99.99 plus tax" or as "$99.99 plus $4.00 tax," or as $103.99 including Minnesota use tax."

In the computation of the amount of use tax to be collected on any transaction, amounts of less than 1/2 cent may be disregarded and the amounts of 1/2 cent or more shall be considered as an additional cent. Thus, on a sale of 12 cents or less, the purchaser pays no tax; on a sale between 13 cents to and

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including 37 cents, he is required to pay one cent tax; on a sale between 38 cents to and including 62 cents, he is required to pay two cents tax; on a sale between 63 cents to and including 87 cents, he is required to pay three cents tax; on a sale of 88 cents to and including $1.12, he is required to pay four cents tax; on a sale in excess of $1.00, he is required to pay four percent on each full dollar plus the appropriate amount from the brackets above.

Tax S&U 304 Registration.

(a) Every corporation authorized to do business in Minnesota (see M. S. Chapter 303 for provisions regarding "foreign corporations" authorized to do business in Minnesota) and every retailer maintaining a place of business in Minnesota (see Section 297A.16) making sales of items subject to the imposition of the "use tax" under Section 297A.14, shall secure a Sales and Use Tax Permit from the Commissioner of Revenue. The provisions of Section 297A.04 and .05 shall be applicable to any corporation or retailer subject to this regulation.

(b) Any corporation or retailer authorized to collect the use tax pursuant to Section 297A.15 shall file an application for a permit under Section 297A.04 and .05.

(c) Each such applicant shall furnish the Commissioner with the names and addresses of all his agents operating in Minnesota and the location of each of his distribution and sales houses or offices or other places of business within this state.

Tax S&U 305 Property brought into Minnesota. Except as provided in Section 297A.25, Subd. 3 (which exempts personal property from the tax where brought in by a non-resident just prior to becoming a resident), Section 297A.23 casts upon any purchaser of tangible personal property the burden of proving that items subject to the imposition of a use tax under Section 297A.14, which were shipped or brought into Minnesota by such purchaser subsequent to July 31, 1967, were not purchased from a retailer for storage, use or consumption in Minnesota. Whether the property has been purchased for use in Minnesota usually will be determinable at or near the time of its purchase. Thus, a non-resident purchaser who can show that property which had been purchased and previously used in another state for a reasonable period of time before being brought into Minnesota for use therein, usually will be deemed to have satisfied the requirements of Section 297A.23.

Example 1. Contractor with his principal place of business in Wisconsin is engaged to construct a portion of an interstate highway in Minnesota. In order to perform the work, he brings into Minnesota various pieces of heavy equipment previously purchased and used in his roadbuilding activities in other states. Contractor's records substantiate the previous purchase and use of this equipment outside Minnesota. Accordingly, no use tax is due.

Example 2. Same facts as in Example 1 except that Contractor purchases three additional pieces of equipment necessary for the Minnesota job and has

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such equipment delivered into this State. Consequently, the presumption that the three additional pieces of equipment were purchased for initial use in Minnesota cannot be overcome by Contractor.

Whether a use tax is due and payable to Minnesota depends upon whether a tax has been paid to some other state. Such credit is limited to sales or use tax paid to any other state of the United States. In this connection see Section 297A.24.

Tax S&U 306 Credit against use tax. Under Section 297A.24, a credit is allowed against the use tax due under Section 297A.14 from any person on any item purchased by such person where such item has previously been subjected to a sales or use tax in another state. The credit shall be allowed to the extent of the rate imposed on such item in the other state. If the rate imposed by such other state is equal to or higher than the rate imposed under Section 297A.14, then no tax shall be due thereon.

Example 1. Corporation located in Minnesota purchases a special machine for delivery in State Y for $30,000.00 plus six percent sales tax imposed by State Y. Corporation then transports the machine back to Minnesota in its own truck. As State Y sales tax rate is in excess of the rate imposed under Section 297A.14, no use tax is required to be paid to Minnesota on the machine. Subsequently, B Corporation purchases for delivery in Minnesota, accessory equipment for the machine from the same vendor in State Y at a cost of $5,000.00. As a result thereof, no sales tax is paid to State Y on the accessory equipment. Consequently, a use tax of $200.00 is due to Minnesota in respect of the accessory equipment. The unused credit of the original purchase, that is, the difference between the $1,800.00 sales tax paid in State Y, and the $1,200.00 use tax imposed under Section 297A.14 may not be applied against the purchase of the accessory equipment or any other subsequent purchase made by the B Corporation.

Example 2. Minnesota resident purchases tangible personal property from a vendor in State X for $3,000.00. He accepts delivery of the property in State X and pays a sales tax at the five percent rate imposed on sales in that state. When such property is brought into Minnesota for use in this state, a use tax return must be filed. However, as the rate upon which the sales tax was imposed in State X is in excess of the four percent rate imposed by Minnesota, no use tax is due in Minnesota thereon.

Example 3. Same facts as in Example 2, except that the sales tax was imposed in State X at the rate of 3%. The amount of the use tax due to Minnesota is calculated as follows: Tax on $3,000.00 at 4% (Minnesota rate) = $120.00. Credit for tax paid to State X ($3,000.00 at 3%) = $90.00. Amount required to be paid to Minnesota, $30.00.

Example 4. Minnesota Resident trades in an old machine in State V. The list price of the new machine is $2,600.00, and Minnesota Resident is allowed $1,000.00 trade-in allowance on the old machine. State V does not allow a deduction for value of the trade-in when determining tax liability. Minnesota

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Resident pays a tax of 2% of $2,600.00 ($52.00) to State V. The new machine is brought to Minnesota for use. The use tax imposed by Section 297A.14 is computed as follows: Tax in Minnesota, represented by the sales price of $2,600.00, less $1,000.00 trade-in allowance (see Section 297A.01, Subd. 8), at the rate of 4% equals $64.00. Tax on $1,600.00 in State V at 2% equals $32.00. Tax due to Minnesota, $32.00. This calculation is based on the provisions of Section 297A.24 which states that the provisions of Section 297A.14 shall apply only at the rate measured by the difference between the rate fixed by Section 297A.14 and the rate by which the previous tax was calculated.

A Minnesota resident who erroneously pays a sales tax to another state may not take a credit against the tax due Minnesota on his Minnesota return. Credit is allowed against the tax due Minnesota if the Minnesota resident has legally paid a sales tax to another state and may only be taken by the person who paid the tax to the other state. Example: A Minnesota retailer purchasing appliances in Iowa for resale and paying the Iowa sales tax cannot deduct from his Minnesota sales tax return the tax paid to the State of Iowa.

Credit for taxes paid to other states is limited to the sales and use tax paid to another state in the United States. This credit is not allowed for taxes paid to governmental subdivisions or foreign countries.

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CHAPTER FOUR: Tax S&U 400-499 EXEMPTIONS

Tax S&U 400 Food products.

A. The Sales and Use Tax Law exempts the sale of food products for human consumption. However, a tax is imposed on the furnishing, preparing or serving, for a consideration, of food, meals or drinks. See Tax S&U 108(b) for criteria determining taxability.

B. "Food products" include, but are not limited to, cereal and cereal products, butter, cheese, milk and milk products, oleomargarine, meat and meat products, fish and fish products, eggs and egg products, vegetables and vegetable products, fruit and fruit products, spices and salt, sugar and sugar products, coffee and coffee substitutes, tea, cocoa and cocoa products.

"Food products" also include the following items: baking powder and soda, breath mints, beverage powders, candy, edible cake decorations, cough drops, crackerjacks, chips (potato, corn, etc.), chip dip, cooking oils, cooking wine, flavoring, fizzies, freezer pop ingredients, food coloring, gelatin, ice cream, fruit juices, lozenges, malted milk powder, nuts, non-alcoholic cocktail mixes, raisins, saccharin and other sweeteners, salad dressing, seasonings, condiments, herbs, relishes, sauces, gravies, sherbet, shortening, soft drinks, vanilla, vitamins, tonic water and charged water.

C. Beer, alcoholic beverages, non-edible cake decorations, Easter egg dye, gum, garden seeds, ice cubes, pet food, softener salt, distilled water and spring water are not "food products".

D. When a package contains both food and non-food products (a holiday basket of food or candy, trays of assorted meats, cups or glasses filled with food items, etc.) the application of the tax depends upon the relative value of the components. When the retail value of the non-food portion of the package is 10% or more of the total retail value, tax applies to the retail value of the non-food portion if its price is stated separately; if the price of the package is a lump sum, tax applies to the entire price. When the retail value of the non-food portion of the package is less than 10% of the total retail value, the entire package is exempt.

Tax S&U 401 Drugs, therapeutic and prosthetic devices.

A. In general. Minn. Stat. 297A.25, subd. 1(b) provides for exemption from sales and use tax for therapeutic and prosthetic devices, prescription glasses and similar products consumed by humans for the preservation of health. Also exempt are diagnostic materials for individual use and prescribed drugs and medicines (prescribed or non-prescribed) used in the cure, mitigation, treatment or prevention of illness or disease in humans.

Devices which are not exempt because they are not inherently therapeutic

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include dental and surgical tools and apparatus, anesthesia equipment, diagnostic and monitoring equipment and materials, protective equipment, and items in general use, such as furniture, air conditioners, air filters, humidifiers not exclusively for use with inhalation therapy equipment, and exercise equipment.

B. Exempt drugs. Items shall be deemed to be exempt drugs where they are used in the cure, mitigation, treatment or prevention of illness or disease, or the treatment of an injury in humans, or to be consumed for the preservation of health in accordance with words, statements or pictures on the labels of the containers of packages in which such items are sold.

C. Therapeutic and prosthetic devices are exempt. To qualify for exempt status, a therapeutic device must not only be useful in the preservation of health, it must also serve to cure or heal. Exempt therapeutic devices are attached or applied to the bodies of human patients to alleviate injuries, illness or disease, either directly or by administering a curative agent. Examples of exempt items are hypodermic syringes, oxygen tents, vaporizers, resuscitators, hospital beds and equipment and supplies necessary for dialysis treatment.

Prosthetic devices are those which replace injured, diseased, or missing parts of the human body, either temporarily or permanently.

D. Cosmetics and toiletries. "Cosmetics" which are defined as articles intended to be rubbed, poured, sprinkled or sprayed on, or otherwise applied to the human body or any part thereof for cleansing, beautifying, promoting attractiveness or altering appearances are not exempt from the tax.

Toiletries are generally items used for shaving, hair dressing and grooming purposes, and are somewhat analogous to cosmetics. Toiletries are not exempt from the tax.

E. Purchases by doctors of medicine and dentistry. The purchase of materials, supplies and equipment are subject to the sales and use tax unless the particular item purchased is itself an exempt item when purchased by an individual for his own use. For example, the purchase by such professional men for use in their own office of drugs and medicines would not be subject to tax, nor would the purchase of prosthetic devices such as artificial limbs or eyes be subject to tax.

The purchase by doctors of medicine and dentistry of materials such as pumice, tongue depressors and stethoscopes, which are not in and of themselves exempt from the tax, would be subject to tax when purchased by such professional men.

Sales of tangible personal property to dentists, which are to be affixed to the person of his patient as an ingredient or component part of a dental prosthetic device, are exempt from the sales tax. These include artificial teeth and facings, dental crowns, dental mercury and acrylic, porcelain, gold, silver, alloy and synthetic filling material, teeth braces and retainers.

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The exemption does not apply to diagnostic equipment such as an x-ray machine, as this equipment is subject to tax.

F. Sales and purchases by ophthalmologists, optometrists and opticians. Sales of prescription glasses and items incidental thereto or which become parts thereof, such as carrying cases and contact lens solution, are exempt. "Prescription glasses" are any lenses ordered by a doctor of medicine or optometry for the correction of a patient's refractive error, for the improvement of a patient's vision, or for protective purposes. Only lenses which have been prescribed by an ophthalmologist or optometrist pursuant to an examination of the particular client are exempt, whether dispensed by the examining practitioner or by another practitioner or optician filling such prescription.

Over-the-counter sales of lenses and other tangible personal property without prescription therefor in accordance with the above are taxable. These include safety glasses; sunglasses; telescopes; binoculars; field glasses; opera glasses; lorgnettes; magnifying glasses; jewelry, including spec chains.

Ophthalmologists and optometrists are primarily engaged in rendering professional services. The entire charge by them, comprised of fees for examining eyes and fitting glasses, and of the glasses sold pursuant thereto, are exempt whether separately stated or not. Practitioners sho are engaged in sales solely of services and such prescribed glasses need not procure sales and use tax permits or file sales tax returns. Practitioners who engage in sales of taxable items in addition to services and prescribed glasses must obtain sales and use tax permits and must thereafter collect and remit taxes due thereon.

Opticians are primarily engaged in the business of selling tangible personal property at retail. The personal services they render are incidental thereto. They are, therefore, required to procure sales and use tax permits, and to collect and remit the tax on all sales at retail except sales of prescription glasses. Charges made by opticians for eye glasses and kindred products in filling prescriptions of ophthalmologists or optometrists are exempt.

Purchases by ophthalmologists, optometrists and opticians of lenses and other items for resale to clients and customers are exempt. All purchases by them of machinery, equipment, instruments, tools, accessories, appliances, contrivances, furniture and fixtures, and fuel, electricity, gas or steam used for space heating or lighting, used or consumed in connection with their services or business are taxable.

G. Guide list of exempt and taxable items.

1. Exempt:

a. Drugs not requiring a prescription: Analgesics (internal and external, for relief of pain or discomfort), such as Absorbine Jr.; rubbing alcohol; Alka-Seltzer; aspirin; Ben-Gay; Bromo-Seltzer, Bufferin; Infra-rub; liniments; musterole; surin; and 666 Salve. Antacids (for relief of acidity, stom-

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ach discomfort, indigestion), such as Alka-Seltzer; alkoid; bellans; bisodol; chooz; co-gel; creamalin; gelusil; Milk of Magnesia; Rolaids; soda mint; and Tums. Antiseptics (the primary ingredient of such is used for treatment of infection), such as acne preparations; alcohol swabs; bactine; boric acid; Campho-Phenique; Desenex; fostex; isodine; peroxide (3%—not for bleaching hair or other toilet purposes); Phisohex; rubbing alcohol; Sea Breeze; sodium perborate; tincture of green soap; tincture of iodine; tincture of mercurochrome; and tincture of merthiolate. Astringents, such as Burow's Solution and styptic products. Baby needs, such as antiseptic powders; lotions and talcum powders; and oils and ointments. Burn remedies (for treatment of burns or to relieve pain from burns, including sunburn), such as americaine, nupercainal ointment; surfacaine, Unguentine; Vaseline; and vitamin A-D ointment. Cough and cold items, such as aerosol inhalants; antihistamines, such as Coricidin; Aspergum; cough or cold syrups, drops, tablets, preparations; decongestants, such as Contac; inhalants; lozenges; and rubs, such as Vicks. Dental and oral hygiene products, such as analgesic toothache preparations and dental repair kits. Diet aids (considered as foods), such as Metrecal; Nutrament; salt substitutes; and Sustagen. Emollients (antiseptics, protective, antibiotic, and anti-inflammatory), such as antibiotic ointments; Boric acid; caladryl; calamine lotion; camphor ice; Kerodex Barrier Cream; lip ice; Lobana Loto-Creme; and Zinc-Oxide ointment. Eye preparations (for healing, treatment or other therapeutic use), such as contact lens solutions; drops, ointments and washes. Feminine and contraceptive needs, such as creams; foams; jellies; pessaries; powders; prophylactic devices; and suppositories. First-aid products (for treatment of infection or to relieve pain), such as back plaster; band-aid; foam and moleskin products (adhesive); mustard plaster; surgical cotton; surgical dressings; surgical gauze; and surgical tape. Foot products (for treatment or prevention of infections, or for removal of corns or callouses), such as athlete's foot preparations or treatments and corn pads and callous plasters. Laxatives, cathartics, such as Alophen pills; Ex-Lax; Feenament; Milk of Magnesia; and mineral oil. Miscellaneous dosage forms, such as enema preparations; insulin, rectal preparations and suppositories. Vitamin-mineral products, such as Brewers yeast; cod liver oil; dietary supplements; Geritol; and therapeutic vitamins.

b. Therapeutic and prosthetic devices: First-aid, such as first-aid kits and infra-red lamps and bulbs. Hypodermic syringes and needles. Medical-surgical rubber goods, such as catheters; heating pads, hot water bottles; ice bags; rubber gloves and finger cots; and surgical rubber goods (colostomy devices, etc.). Miscellaneous medical-surgical, such as abdominal belts and supports; batteries (hearing aid); bedwetting prevention devices; breast pumps; cotton tip applicators (Q-tips); elastic bandage; elastic stockings; elastic supports (wrist, ankle, knee); infant syringes; medical atomizers, nebulizers and vaporizers; suspensories; and trusses. Orthopedic devices, such as braces; canes; crutches; splints; and wheelchairs. Surgical dressings and bandages, such as elastic bandages.

c. Diagnostic agents (for individual use): Clinitest tablets; fever thermometers; Tes-Tape.

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d. Miscellaneous: Pesticides, such as Cuprex.

2. Taxable toiletries, cosmetics, and equipment:

a. General:

Antiseptics, such as B. K. Powder; for general household cleaning agents, such as Clorox bleach, Hilex and Lysol; peroxide (20%) for bleaching hair and other toilet purposes. Astringents, such as astringent aftershave products and astringent deodorants, Dental and hygiene products, such as dental floss; liners; mouthwashes; stain removers; toothbrushes; and toothpastes and powders. Eye preparations, such as cosmetics. Feminine and contraceptive needs, such as belts; douche kits; sanitary napkins; and tampons. Foot products (for comfort, appearance or cosmetic use), such as deodorizers and foot lotions (for cosmetic use).

Miscellaneous items such as ultra-violet (sun) lamps and bulbs; air conditioners and purifiers; athletic supporters; atomizers for cosmetic and grooming use; baby and bathroom scales; bedpans; filter masks; humidifiers; massage appliances and furniture; medic alert bracelets; oxygen tanks; sheeting (plastic and rubber); tongue depressors; urinals; and whirlpool baths.

Shaving Products, such as aftershave talcum powders and lotions; blades; razors; shaving cream; and soaps.

Facial preparations, such as face creams and makeup preparations and accessories. Fragrance preparations, such as colognes; perfumes; and toilet waters. Hair care items, such as combs; curlers; dandruff shampoo; dyes; hats; lotions; rinses; shampoos (all kinds except on Tx); tints; and wave sets. Hand products, such as beautifiers; and creams and lotions. Suntan preparations (for tanning), such as Bronze Tan; Coppertone; Sea and Ski tan; and Skol.

Pesticides, such as Black Flag spray or liquid; bug bombs; insect repellents such as 6-12; mothballs; rat poison; and D-Con.

b. Detailed listing:

Aftershave creams, lotions or powders; almond meal and paste; antiperspirants; aromatic cachours (Sen Sen); astringents (aftershave, antiperspirants, cosmetic, etc.); atomizers (containing perfume and other taxable liquids); bandoline; bath crystals; bath milks; bath oils; bath powders; bath salts; bath tablets; bay rum; beauty creams; mask preparations, etc.; bleach creams and lotions (including freckle remover); bouquet liquids; breath sweeteners; brilliantines; and bubble bath preparation; cleansing creams and lotions (including those for removing stains from the skin); cocoa butter (if advertised or labeled for toilet purposes); cold cream; colognes; compacts (containing rouge or powder); compact refill cosmetics; cosmetic stocking preparations and body paints; cuticle softeners and removers; depilatories; deodorants (even though having medicinal or curative value, if advertised or labeled for use as body deodorant); deodorants (for use in closets, bureau drawers, etc., and for

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imparting fragrance to clothing); dusting powders; essences (and extrancts, perfume); eyebrow pencil; eyelash mascara (and eyelash and brow dyes); eye shadows; face creams; face lotions (and facial oils); face packs; face powders (loose and cake form); fingerwave lotions; floral essences; foundation makeup film; freckle removers; fuller earth (if recommended for toilet purposes); Glycerine and rose water; hair bleaches; hair dressings; hair dyes; hair lotions; hair oils; hair pomades; hair removers; hair restoratives; hair sprays; hair straighteners; hair tints and rinses; hair tonics; hand creams; hand lotions; henna; hypo-allergenic preparations (including cleaning preparations and soaps); kleenex; lavender water; leg makeup; lip pomade; lipsticks and lipstick refills; liquid face powder; liquid lip color; liquid stockings; manicure preparations; mascara; mittens (containing toilet powder); mustache wax; nail bleaches; nail polishes (paste, powder and liquid); nail whitener; Noxema; olive oil (colored or perfumed, or recommended for toilet purposes); orange flower water; orris root; perfumes; perfume ingredient kits; perfume novelties (containing perfume); permanent waving creams, lotions, neutralizer); permanent waving kits; peroxide (regardless of strength, if for use in bleaching hair or for other toilet purposes); plucking creams (for use in connection with plucking hair); pore cleansers; powder bases (liquid and cream); protective creams (having toilet claims or used as skin creams or antiperspirants); rock salt bath crystals; rose water; rouges; sachets (containing powder or aroma-producing materials); scalp lotions and ointments (for use as treatment for dry, oily or falling hair); shampoos (except Rx); skin balms, bleaches, creams, fresheners, lotions, oils, tonics, whiteners, stain removers; shaving preparations; sunburn preventatives (if recommended for use before exposure); talcum powder; texture creams; tissue creams; toilet ammonia; toilet creams; toilet lanolin; toilet waters; tucks; vanishing creams; washettes; water softeners (perfumed or having toilet claims); wave set (paste, powder and lotion); witch hazel; and wrinkle removing or concealing preparations.

Tax S&U 402 Exemptions in accordance with constitutional prohibition against taxation.

(a) In general. Section 297A.25, Subd. 1(c) exempts from the provisions of the Sales and Use Tax Law, the gross receipts from the sale of, and the storage, use or other consumption in Minnesota of tangible personal property which the United States Constitution or the State Constitution exempts from taxation.

Thus, by reason of the doctrine of "intergovernmental immunity" developed by the Federal courts in their construction of the Federal Constitution, the State of Minnesota is precluded from imposing a tax upon the Federal government, its agencies, and instrumentalities.

The commerce clause of the Federal Constitution precludes the imposition of a sales or use tax when such sale or use is an integral part of interstate commerce.

The due process clause of the 14th amendment of the Federal Constitu-

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tion prohibits any state from attempting to tax the sale or use of tangible personal property when such sale or use occurs outside its territorial jurisdiction.

Tax S&U 403 Property shipped out of state. From August 1, 1967, through May 21, 1973, sales of tangible personal property were exempt when the ultimate destination of such property was outside Minnesota and the property was not returned to Minnesota except in the course of interstate commerce. Ultimate destination as used in Section 297A.25, Subd. 1(d), was defined by court decision to mean not the point of delivery to the buyer, but the point at which the beneficial use of the product would take place.

After May 21, 1973, Section 297A.25, Subd. 1(d), as amended, grants an exemption in either of the following two situations:

(a) For property for business or personal use which the seller delivers to a common carrier for delivery outside Minnesota, places in the United States mail or parcel post directed to the purchaser outside Minnesota, or delivers to the purchaser outside Minnesota by means of the seller's own vehicles, and which is not returned to Minnesota except in the course of interstate commerce.

(b) For property which is shipped or transported outside of Minnesota by the purchaser without any intermediate use (except storage, processing, fabricating or manufacturing into other property), is used in a trade or business outside Minnesota, and is not returned to Minnesota except in the course of interstate commerce.

In order to claim this exemption the seller must have adequate records to show that he caused the property to be delivered to the purchaser at his location outside Minnesota or the seller must obtain an exemption certificate from the purchaser stating that the first beneficial use of the property will occur outside Minnesota and that the property will not be returned to Minnesota thereafter unless in the course of interstate commerce.

As used herein the term "intermediate use" does not include storing, processing, fabricating, or manufacturing into, attaching to or incorporating into other tangible personal property, but means a beneficial use consisting of consuming, enjoying, or using the property sold in a manner in which it was designed and manufactured to accomplish. For example, in the case of mobile transportation equipment, the first use would not include the using of such property to transport it immediately to a point outside of Minnesota. However, the purchase of replacement tires in Minnesota would be subject to tax.

Effective January 1, 1974, Section 297A.25, Subd. 1(w) provides an exemption for advertising materials which are designed to advertise and promote the sale of merchandise or services if the material is purchased and stored for the purpose of subsequently shipping or otherwise transferring outside the state by the purchaser for use thereafter solely outside the State of Minnesota.

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Tax S&U 404 Gifts—transfers without monetary consideration.

A. Generally a person purchasing property to give away in any manner is the user or consumer thereof and is liable for the sales tax thereon. Examples: all property given as personal gifts, calendars, catalogs, etc.

Except as provided in clause B. and C. of this regulation sales to any person in Minnesota of tangible personal property located in this state which such person gives to any other person as a gift are subject to the sales or use tax even though the vendor delivers the property directly to the donee at a point outside Minnesota and without regard to whether such delivery is made by mail, common carrier, or otherwise. It is deemed that such property is constructively delivered to the purchaser in Minnesota and that the transportation and delivery to the outstate destination is pursuant to a transfer by gift from the donor to the donee.

B. Sales to any person of tangible personal property which is designed to advertise and promote the sale of merchandise or services and which is transferred by the purchaser thereof without consideration to others located outside of Minnesota are not taxable. See Tax S&U 403.

C. Sales to any person of tangible personal property which the purchaser thereof will use as prizes or gifts for salesmen or other persons employed in such person's business outside of Minnesota are not taxable.

Tax S&U 405 Cartons and containers used by moving and transfer companies. From May 22, 1973, packing materials used to pack and ship household goods to a destination outside of Minnesota and not returned to Minnesota except in the course of interstate commerce are exempt. An exemption certificate must be furnished to the seller when such packing materials are purchased.

Prior to May 22, 1973, packing materials used to pack and ship household goods are taxable. In these situations the furnishing of cartons and containers for packing and safe transport of property by trucking concerns engaged in the business of transporting property for hire is a sale within the meaning of Section 297A.01, Subd. 3, if an applicable tariff specifies that such cartons or containers become the property of the customer or if the customer is charged a specific amount therefor on the contract or billing. Also, if the property was transported from Minnesota to a point without this state, title to the cartons or containers is deemed to have passed to the customer in Minnesota prior to use of the cartons by the carrier for packing unless it could be demonstrated that title did not pass until delivery to the destination.

In the case of use of cartons or containers for packing within Minnesota, prior to May 22, 1973, where it could be demonstrated that title did not pass until delivery at an outstate destination, or where neither the ICC tariff, contract or billing indicated a sale of the cartons or containers, the carrier is subject to the use tax imposed by Section 297A.14.

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Tax S&U 406 Petroleum products. An exemption from sales and use tax is provided for petroleum products upon which a tax has been imposed under M. S. Chapter 296, regardless of whether any part of the tax is subsequently refunded. The tax imposed by M. S. Chapter 296 applies to all gasoline (including aviation and marine gasoline), and special fuels for highway or aircraft use.

All fuels not subject to the tax imposed by M. S. Chapter 296 are subject to sales and use tax unless exempted under other provisions of the Sales and Use Tax Law.

Example. Trucking Company is a "bulk purchaser" (as defined in Section 296.01, Subd. 19) and orders 100,000 gallons of petroleum products in October, 1968. It instructs the distributor to deliver 70,000 gallons to a storage tank used to supply such petroleum products to licensed motor vehicles owned and operated by it. The remaining 30,000 gallons are delivered to a storage tank used to supply fuel oil for heating Trucking Company's premises. For the month of October, 1968, Trucking Company reports and pays the "special fuel" (as defined in Section 296.01, Subd. 6) excise tax on 70,000 gallons. Trucking Company files a sales and use tax return (if it has a Minnesota sales tax account number) or a Consumer's Use Tax Return (if it has no such account number) and reports as taxable the 30,000 gallons of petroleum products used by it for space heating, and pays a tax based upon the price per gallon multiplied by the 30,000 gallons not subjected to the highway use tax. See Section 297A.14 for application of use tax.

Tax S&U 407 Clothing and wearing apparel.

A. In general. Sales of clothing and wearing apparel are exempt from tax. "Clothing and wearing apparel" means inner and outer wear, footwear, headwear, gloves and mittens, neckwear, hosiery and similar items customarily worn on the human body for general use, and includes fabrics, thread, buttons, zippers and other similar items which are to be directly incorporated into wearing apparel.

"Clothing and wearing apparel" does not include patterns, thimbles, needles, pins and other sewing equipment, jewelry, handbags, cosmetics, articles normally used or worn only in conjunction with the particular sporting or athletic activity for which they were designed, or equipment designed for use or wear only in connection with a particular work activity of the user.

Minn. Stat. § 297A.25, subd. 1(g) provides that an article made of fur or pelt is not considered to be clothing or wearing apparel and is, therefore, taxable. Articles made of fur or pelt and other materials are exempt only if the retail value of the fur or pelt is less than three times that of the next most valuable material. Clothing made of synthetic fur is exempt from tax.

Example 1. Retailer sells a woman's wool coat which has a mink fur trimming. The retail value of the fur is $40.00; the retail value of the wool material is $90.00. The sale of the coat is exempt from tax.

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Examples of Exempt items:

aprons (household and shop)
baby blankets (used as babies' clothing)
baby buntings
bathing suits and caps
belts
bibs
blankets, baby and receiving (used as babies' clothing)
boots (not more than knee high)
bridal wear
buntings
caps
corsets and corset laces
costumes (except masks)
diapers, diaper inserts, disposable diapers
footlets
formal wear
garters and garter belts
girdles
gloves (not designed for a specific sport)
hair bows and nets
handkerchiefs
hats
head scarves
hosiery
leotards
mittens
neck scarves
neckties
overshoes
receiving blankets (used as babies' clothing)
roller bonnets
rubber gloves
rubber pants (baby)
scarves, head and neck
sewing materials:
- buttons
- fabric
- lace
- thread
- yarn
- zipper

shoes and shoe laces
shower caps and clogs
slippers
sneakers
suspenders
swimsuits and caps
tennis shoes
tights
uniforms (Scout, Camp Fire Girls, policemen, firemen, etc.)

Examples of Taxable items:

bags, overnight, beach, etc.
barrettes
billfolds
cosmetics, hair dyes, etc.
crib blankets, sheets, mattress pads, rubber sheets, etc.
furs on the hide or pelts
hair clips
handbags
iron-on transfers or emblems
jewelry:
- bracelets
- broaches
- cufflinks
- earrings
- necklaces
- pins
- rings
- tie clasps and tacks

lapel pins
money belts
money clips
perfume
pocketbooks
purses
sewing equipment:
- knitting needles
- patterns
- pins
- scissors
- sewing machine
- sewing needles
- tape measure
- thimbles

umbrellas
wallets
watchbands
watches
wigs

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B. Athletic, sporting and recreational articles. Certain articles which may be designed primarily for use while engaging in particular sports may also be worn for general use. For example, a motorcylce or snowmobile helmet may be worn by a user traveling to and from work, or by a farmer while being transported by snowmobile from one work area to another on the farm. Articles such as these are deemed to be "clothing and wearing apparel". Sales thereof are exempt. Certain articles are normally used or worn only in conjunction with the particular sporting or athletic activity for which they are designed. For example, football helmets, pads, uniforms and shoes are designed and commonly used for a specific athletic activity and are not commonly used for other purposes. Other items, such as athletic supporters, are commonly worn only in connection with sports activities. These items are not included within the category of "clothing and wearing apparel". Sales thereof are taxable.

1. Examples of Exempt items:

ski, snowmobile and motorcycle suits, pants, socks, jackets, gloves, helmets and liners, sweaters, etc.
shoe pacs
insulated boots
snowmobile boots
insulated underwear, coveralls, etc.
caps and hats, ski, hunting, fishing golf and baseball
safety shields and visors for snowmobile and motorcycle helmets when attached and sold as an inseparable part of the helmet, and the price is not stated separately
name patches or emblems on suits and jackets when sold attached, and the price is not stated separately
bowling shirts
sweat shirts
sweat suits
bathing suits and caps
beach capes and coats
tennis shorts, shirts, sweaters, dresses and shoes
hunting jackets and trousers, canvas or leather front, insulated or uninsulated, lined or unlined
camouflage parkas and trousers
rain wear (ponchos, jackets, parkas,

2. Examples of Taxable items:

ski boots (designed for skiing only)
safety shields and visors, detachable for snowmobiling or motorcycling if sold separately (that is, if helmet may be purchased with or without safety shield)
goggles (non-prescription)
name patches or emblems for suits and jackets, if sold separately (that is, if snowmobile suit may be purchased with or without the name patches or emblems)
uniforms, baseball, football, basketball, hockey, track, etc.
gloves, baseball, hockey, boxing bowling, golf, etc.
shoes, bowling, baseball, football, track, golf, etc.
helmets, football, hockey, baseball, etc., baseball masks, chest protectors, or shin guards
shoulder pads and padding
athletic supporters
fishing boots (hip boots and waders)
skin-diving suits, goggles, fins, equipment, etc.
shell belts and vest
fishermen's wading vests and jackets
hunting or game pouches and carriers
life preservers, vests, belts

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1. Examples of Exempt items (Cont.):

shirts and trousers)
ballet and tap shoes
dancing costumes
gym suits and shorts
leotards and tights

C. Safety and protective articles. Articles designed primarily to provide safety or protection against injury, while the user is engaged in industrial or general job activities, are not included within the exemption provided for "clothing and wearing apparel" in Section 297A.25, Subd. 1(g). These items are generally referred to as, "safety equipment" and can be included within two or more of the following categories:

1. The article is principally purchased and used for the purpose of performing an industrial or general job activity;

2. The article cannot normally be purchased from retailers in the business of selling "clothing and wearing apparel" to the general public for everyday use; and

3. The articles contain materials that would not be needed if they were only subject to general everyday use. (i.e., Asbestos is not needed in gloves used for dress or to protect hands from general environmental conditions such as cold, moisture, dirt, etc. However, it is needed to protect hands from heat exposure not normally encountered in general everyday life such as that existing in foundry and steel making operations.)

Articles worn for general use as well as in industrial or general job activities and not includable in two of the above three categories, are considered to be within the exemption provided for "clothing and wearing apparel" and are exempt sales.

a. Examples of Exempt items:

coveralls, uniforms
work clothes, etc.
overshoes
work shoes
cloth gloves
safety glasses and goggles (prescription)
hard hats and liners

b. Examples of Taxable items:

breathing masks
ear and hearing protectors
face shields
reflective or asbestos vests, aprons, gloves, suits, etc.
welding helmets
safety glasses and goggles (non-prescription)
safety belts
finger guards

Tax S&U 408 Property used in agricultural and industrial production.

A. Agricultural and industrial production. Agricultural and industrial pro-

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duction includes, but is not limited to, the following: manufacturing; farming; processing of agricultural products either vegetable or animal (other than by restaurants or consumers); commercial fishing; refining; smelting or reducing minerals, ores, petroleum products, etc.; brewing and distilling of alcoholic beverages and products; printing; mining; quarrying; lumbering; generating electricity; horticulture; floriculture; raising of pets or fur-bearing animals or research animals or horses on a commercial basis. In addition, agricultural and industrial production includes any step or steps in the production process and the production, fabrication, printing or processing of tangible personal property for consumers, defined as a sale under Minn. Stat. 297A.01, subd. 3(b).

Generally, the production process begins with the removal of raw materials from stock for the purpose of commencing activities effecting changes thereon in the course of development of the intended product. The production process ends when the completed state is achieved, except that materials used in packaging finished goods shall be regarded as used or consumed in the production process.

In the case of mining, the production process shall be deemed to begin with the removal of overburden from the site of the ore deposit and to end when the last process prior to stockpiling is performed. If the product is not stockpiled prior to shipment, the production process shall be deemed to have ended when the last process prior to loading for shipment has been completed.

Quality control, testing, and research and development activities are regarded as part of the production process. The production process does not include the storage and preservation of raw materials; the handling, storage and preservation of completed goods; or the painting, cleaning, repairing and maintenance of equipment and facilities.

Effective January 1, 1974, the exemptions for industrial and agricultural production, provided for under the provisions of Minn. Stat. § 297A.25, subd. 1(h), have been amended to include "accessory tools, equipment and other short lived items, which are separate detachable units used in producing a direct effect upon the product, where such items have an ordinary useful life of less than 12 months." Therefore, any reference, direct or indirect to accessory tools, equipment and other short lived items in section (a), (b) and (c) of this regulation, should be construed to apply to the period of August 1, 1967 through December 31, 1973. Information concerning the additional exemptions allowable as of January 1, 1974 may be found in section (d) of this regulation.

B. Exempt materials. Minn. Stat. § 297A.25, subd. 1(h) provides exemption for all materials used or consumed in agricultural or industrial production of personal property intended to be sold ultimately at retail, whether or not the item so used becomes an ingredient or constituent part of the property produced. Items included in the exemption are chemicals, fuels, petroleum products, lubricants, packaging materials, feeds, seeds, fertilizers, electricity,

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gas and steam. Also exempt are all materials that are ingredients or component parts of the product, and materials that act on or come in contact with the product but that are not machinery, equipment, implements, tools, accessories, appliances, contrivances, furniture or fixtures. Examples of such exempt materials are grinding compounds, polishing compounds, and lithographic printing plates. The phrase "used or consumed in agricultural or industrial production" also includes materials that are only used once in production and even though they have not been physically consumed they will not be used again. Examples of such exempt materials that could qualify for this exemption are keylines, typeset, paper pan and cake liners.

Also exempt are all forms of animal life of a kind the products of which ordinarily constitute food for human consumption.

C. Taxable equipment. The exemption provided by Minn. Stat. § 297A.25, subd. 1(h) does not include machinery, equipment, implements, tools, accessories, appliances, contrivances, furniture or fixtures, or fuel, electricity, gas or steam used for space heating or lighting. Accordingly, a sales or use tax is imposed on not only a machine itself and any repair parts for it, but also the tool or accessory that performs the work of the machine, including saw blades, grinding wheels, cutters, files, molds, dies, patterns, jigs, printing plates and similar items. Refer to clause B. above for certain printing plates that qualify for exemption.

Also taxable are materials purchased by a person engaged in agricultural or industrial production to manufacture or fabricate equipment, tools, etc., for his own use in the production process and not intended for resale. Examples of such materials are lead used in making printing plates, metal or wood used in making patterns or jigs, and sand used in making molds.

D. Exemptions effective January 1, 1974. Exemptions for industrial and agricultural production, provided for under the provisions of Section 297A.25, Subd. 1(h), have been amended to include, "accessory tools, equipment and other short lived items, which are separate detachable units used in producing a direct effect upon the product, where such items have an ordinary useful life of less than 12 months." To clarify the administration of this amendment the words, "separate detachable units, used in producing a direct effect, and ordinary useful life", are determined to have the following meanings:

1. Separate detachable unit: This refers to accessory tools, equipment or short lived items that are attached to machinery when being used. These items are generally purchased separately from the purchase of the basic machine, and do not include the basic machine and its component parts such as belts, pulleys, gears, shafts, bearings, etc. Examples of items considered to be "separate detachable units" include but are not limited to drill bits, cutting tools, grinding wheels, abrasive and polishing belts, sheets and discs, taps, reamers, printing plates, saw blades, and certain dies, jigs, patterns and molds; however, if these items are included in the purchase price of the basic machine, and are not separately stated, they will be considered as part of the

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basic machine and taxable. Subsequent replacement of these items will be considered exempt. In addition to the basic machine and its repair parts, hand tools, such as hammers, pliers, and clamps, wrenches, screwdrivers, crowbars, etc., are not considered to be "separate detachable units" and are thus taxable.

2. Used in producing a direct effect: Accessory tools, equipment and other short lived items are included within this definition if they are used or consumed in industrial or agricultural production in a manner which directly causes a physical or chemical change upon or within the materials being processed. Examples of items within this exemption include but are not limited to drill bits, cutting tools, grinding wheels, abrasive and polishing belts, sheets and discs, taps, reamers, printing plates, saw blades and certain dies, jigs, patterns and molds. Examples of items not exempt under this provision are conveyor belts, rollers, etc., that only serve to move the product from place to place.

The phrase "used in producing a direct effect upon the product" shall not be deemed to imply a requirement for a direct physical contact with the product. Items which do not come into contact with material being processed and are not the agents which by direct contact with the product produce physical or chemical changes shall nevertheless be considered to be "used in producing a direct effect upon the product" if their use serves the purpose of determining the shape, contour, configuration, content or arrangement of content of the item (or any part thereof) being produced. Such items shall be considered as "used in producing a direct effect" since the desired change in the material being acted upon is accomplished only by the combined effect of such items acting in conjunction with the items which actually have the direct physical contact with the product.

Items which are used in creating and/or maintaining a condition which must prevail before a desired physical or chemical change can be effected on a product are not considered as being used to produce the direct effect, i.e., the physical or chemical change sought in the material being processed.

To illustrate the application of this principle the following examples of qualifying and non-qualifying items are set forth:

Circuit board drill tapes—These tapes coordinate where holes are to be drilled on the circuit board and electronically guides the drilling apparatus to the proper position. Without this tape being used in conjunction with the drilling apparatus the circuit board would not be able to be manufactured.

Master tapes from which copies are made are the media which determine the arrangement of the magnetic materials on the copy and are therefore considered to be used in producing the direct effect resulting in the reproduction.

Photographic transparencies are used in conjunction with light to produce a desired effect which the light alone would not produce.

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Examples of items not meeting the criteria are: drill extension bars, drill chucks, burner tips. While these items might be considered to be separate detachable units they neither cause the physical or chemical change which might be associated with their use, nor is their use for the purpose of determining the shape, contour, etc., of the item.

3. Ordinary useful life: An item will be considered exempt if the ordinary useful life to the taxpayer is less than 12 months, and the item qualifies as an expense rather than a capital item for Federal income tax purposes. This can be done by providing evidence that prior purchases of similar items had useful lives of less than 12 months. If the taxpayer can prove that his ordinary practice demonstrates a useful life of less than 12 months, then he need not provide that all such items are similarly treated. The taxpayer's normal practice and experience will be determinative. Junking, scrapping, wearing out, or disposition of the item is conclusive evidence of the end of its ordinary useful life. Retention subsequent to usage is not evidence of continued useful life unless the item is again held for use or put into use in the taxpayer's ordinary production process.

E. Packaging materials.

1. General. Sales of materials to persons engaged in agricultural or industrial production for use in packaging, shipping, or delivering tangible personal property produced or manufactured by them are exempt. The term "packaging material" includes non-returnable containers, but does not include returnable containers except as otherwise specified herein.

Price tags, shipping tags and address labels, invoices and advertising matter to be used in connection with the sale of property or to be enclosed with property sold are not included within the meaning of packaging materials.

2. Returnable containers. Returnable containers constitute equipment and in general do not come within the scope of the exemption provided under Section 297A.25, Subd. 1(h). However, purchases subsequent to December 31, 1973 of returnable containers for use in packaging food and beverage products are within the exemption by specific statutory authorization.

Returnable containers include steel drums, barrels, bottles, boxes, cases, tanks, gas cylinders, sacks, cans, etc., which are designed and ordinarily used for more than one-time use as containers. They are customarily expected or required to be returned by customers to the vendor of the contents for re-use. Vendors commonly require a deposit or payment by the customer with the understanding that the amount of the deposit will be refunded either in cash or in credit when the container is returned to the vendor. Regardless of the condition or appearance of the container, it will be deemed to be a returnable container if the vendor required a deposit or payment from the customer, and if there is an implied agreement that the deposit will be refunded upon return of the container. Containers which customers fail to return will not affect the taxable status of such containers. Deposits charged customers

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as security for the return of containers are not subject to tax if such amounts are separately stated on the invoice or billing.

Amounts for materials consumed in the repair or reconditioning of taxable returnable containers are taxable unless the provisions of Tax S&U 102(d) apply.

3. Internal components. Internal components are materials used inside of packages and containers in order to shape, form, preserve, stabilize or protect the contents. Examples include: excelsior, straw, cardboard fillers; separators; shredded paper; ice; dry ice; cotton batting; laths; sawdust and other items of a similar nature. Returnable internal components other than those purchased subsequent to December 31, 1973, for use in packaging food and beverage products are equipment and are not within the packaging materials exemption. Nonreturnable internal components are packaging materials.

4. Dunnage. Sales of bracing, blocking, skidding, shoring and other materials commonly known as dunnage are exempt to persons engaged in industrial or agricultural production of tangible personal property when used in connection with the shipment of their products to customers. However, sales of these same items to vendors of transportation services are taxable unless otherwise exempted by Minn. Stat. § § 297A.01 to 297A.44.

5. Packaging materials used in performing nontaxable services. Sales of packaging materials such as bags, wrapping paper, boxes, clothes hangers, etc., to vendors of personal services do not come within the exemption provided in Minn. Stat. § 297A.25, subd. 1(h), and are taxable. For example, a dry cleaning establishment is a vendor of cleaning and laundering services and uses bags, wrapping paper and clothes hangers when returning customers' property. Sales of such items to the dry cleaning establishment are taxable.

Meat locker operators are vendors of personal services when they cut meat furnished by their customers into smaller pieces, which they wrap and place in cold storage for the customers' convenience. Sales of wrapping paper, tape, etc., for this purpose are taxable. However, meat locker operators who also make retail sales as well as cutting meat furnished by their customers may purchase wrapping materials exempt for resale and report and pay use tax on the portion of the wrapping materials used in performing the cutting service.

Tax S&U 409 Publications.

(a) In general. The exemption of certain gross receipts from the sales and use tax provided for by Section 297A.25, Subd. 1(i) is related to publications regularly issued at average intervals not exceeding three months.

Generally the exemption applies to gross receipts from sales of:

(1) tangible personal property (other than paper products of ink products,) fuel, electricity, gas or steam used or consumed in the production of

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any such publication. (See clause (c) of this regulation for rules regarding paper and ink.)

(2) such publications;

(3) any advertising contained in or with such publications.

Machinery, equipment, etc.; furniture and fixtures; fuel, electricity, gas or steam used for space heating or lighting are not exempt under this provision.

(b) Publication defined. The word "publication" encompasses only written or printed matter, such as a newspaper, magazine or other printed periodical regularly issued at average intervals not exceeding three months.

"Publication" includes any legal newspaper as defined by M. S. Chapter 331, together with any supplements or enclosures accompanying such newspaper or representing a part thereof. The term "newspaper" is limited to those publications commonly understood to be newspapers and which are printed and distributed periodically at daily, weekly, or other short intervals for the dissemination of news of a general character and of general interest. The term does not include hand bills, circulars, flyers, or the like, unless distributed as a part of a newspaper as defined. The term "publication" includes so-called "shoppers guides" distributed by a publisher, where space in such publication generally is available to advertisers for the purpose of inducing readers to purchase goods or services from such advertisers.

House organs, trade, professional and other types of magazines and journals regularly issued at average intervals not exceeding three months are included within the meaning of "publication." "Comic books" are "publications" if published serially under the same title at least once quarterly; however, comic books complete in themselves and without continuity of title and subject matter are not "publications."

The following are representative of items not included within the meaning of "publication": books, including those issued at regular or stated intervals, e.g. books sold by a book-of-the-month or other club or organization; so called "one-shot" magazines that have no literary or subject matter connection or continuity between prior or subsequent issues; price lists; hand bills; catalogs; programs; score cards; maps; sheet music; yearbooks; directories; bulletins; political newsletters issued during a campaign only, and not of a continuing nature at regular intervals not exceeding three months; loose leaf or similar personal service publications such as tax information services, labor information services, credit or financial information services (however, special reports not distributed generally are deemed personal services), law cases and briefs; realtors' descriptive listings, financial and statistical reports, unless published as a supplement or enclosure with or part of a legal newspaper.

(c) Paper and ink. Taxability of paper and ink products used in producing publications exempt under Section 297A.25, Subd. 1(i) should be determined as follows:

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(1) Purchases in period 8-1-67 through 10-31-71 are exempt;

(2) Purchases in period 11-1-71 through 12-31-73 are taxable except paper and ink used as specified in (4) and (5) below;

(3) Purchases subsequent to 12-31-73 in excess of $100,000.00 in any calendar year for use on any publication are taxable except when used as specified in (4) and (5) below;

(4) Paper and ink used in printing an exempt publication of an exempt entity shall not be subject to tax whether such products are purchased by the exempt entity or by a printer who has contracted to print such publication;

(5) The tax shall not apply to paper and ink used in printing any exempt publication as herein defined, which pursuant to a sale as defined in the Sales and Use Tax Law,

(aa) is mailed or shipped to an out-of-state location of an out-of-state purchaser; or,

(bb) is mailed or shipped to an out-of-state subscriber whether the publisher is located in or outside of Minnesota.

Paper and ink purchased for use in producing any publication by a printer who is not also the publisher may be purchased by such printer exempt from sales and use tax provided he gives to the vendor an exemption certificate prescribed by the Commissioner. The publisher of such a publication will be subject to a use tax based upon the cost of such paper and ink products, unless he is exempt under (4) and (5) immediately above.

The person deemed to be producing a publication is the owner and operator who controls the format and who charges advertisers for the privilege of inserting advertisements in his publication, whether or not he prints such publication or pays another to do the printing.

(d) Gross receipts from advertising. The statute specifically provides that the gross receipts from the sale of any advertising material in a publication as defined in Section 297A.25, Subd. 1(i), shall also be exempt. It is further provided that such advertising shall be deemed to be the rendition of a service and not tangible personal property. Further, that persons or their agents engaged in the publication or sale of advertising material shall be deemed to be engaged in the rendition of a service with respect to the gross receipts realized from such news gathering or publishing activities including the sale of such advertising.

Tax S&U 410 Sales to exempt entities, their employees or agents.

(a) In general. The exemptions provided in Section 297A.25, Subd. 1(j) to the United States, its agencies and instrumentalities or to any state and its

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agencies, instrumentalities and political subdivisions, and the exemptions provided in Section 297A.25, Subd. 1(p), to organizations operated exclusively for charitable, religious or educational purposes, apply only to the sale or use of tangible personal property.

The furnishing for a consideration of meals, admissions or lodging as provided in Section 297A.01, Subd. 3(c), (d) and (e) is not considered the sale or use of tangible personal property.

No exemption from the sales and use tax is therefore allowed for meals, admissions or lodging furnished to governmental entities or organizations exempted under Section 297A.25, Subd. 1(p), their employees or agents, even if the organization is billed directly and pays directly for such services, except that the Federal government, its agencies and instrumentalities are exempt under the "intergovernmental tax immunity doctrine" where they purchase meals and lodging directly.

(b) Governmental agency relief orders. No tax attaches to the delivery of tangible personal property to relief clients on orders issued by a governmental relief agency, provided that the charge thereon is made directly to the governmental agency. In such cases the sale of the property is a sale to the governmental unit. The merchant making such sales need not secure an exemption certificate from the governmental agency. Sales of merchandise and other items directly to an individual who is a relief client are not to be deemed sales to a governmental agency and are subject to tax unless otherwise exempt.

Tax S&U 411 Isolated or occasional sales.

A. In general. As provided in Minn. Stat. § 297A.25, subd. 1(k), the sales or use tax does not apply to isolated or occasional sales of tangible personal property made by a person who is not engaged in selling such property in the normal course of business. The term "isolated" is defined as "standing alone or solitary." The term "occasional" is defined as "occurring at infrequent intervals" or as "incidental" or as "casual"; that is, as distinguished from events of a similar nature recurring with some degree of regularity.

B. Isolated or occasional sales. The following transactions are considered to be isolated or occasional sales:

1. Infrequent sales of a non-recurring nature made by a person not engaged in the business of selling tangible personal property.

Example 1. The sale of a used vacuum cleaner by a housewife to a neighbor.

Example 2. Sales by executors, administrators, trustees and other fiduciaries in the liquidation of an estate, except inventory or stock in trade.

Example 3. Sales or executions pursuant to a court order or by a court officer.

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2. Infrequent sales of a non-recurring nature of tangible personal property acquired for use or consumption by the seller, and not sold in the regular course of business of such person.

Example 1. The sale of a typewriter by an insurance company which does not regularly dispose of such equipment.

Example 2. The sale of used machinery, fixtures, equipment and similar items by a person engaged in a business or occupation such as manufacturing or operating a retail store, where such person does not sell such items in the regular course of business. Owner may retain services of auctioneer if sale is conducted on owner's premises and owner's identity is disclosed.

Example 3. The sales of an entire business by the owner thereof except that the transfer of inventory or stock in trade constituting a part of such sale is not exempt as an isolated sale.

C. Non-isolated sales. The following are examples of transactions that are not considered isolated or occasional sales;

1. The sale of property held primarily for sales to customers in the ordinary course of trade or business.

Example 1. Leasing company sells a bulldozer to "X" which was previously used in its business by leasing to others. Inasmuch as leases constitute sales, leasing company is deemed to be in the business of selling this kind of property. The sale of the bulldozer to "X" is not an isolated or occasional sale.

2. The sale of stock in trade or other property of a kind which would properly be included by a manufacturer, wholesaler, retailer, jobber, or other vendor in inventory, even though such sales are infrequent and only comprise an insignificant fraction of the vendor's total business.

Example 1. Sporting goods store sells one power cruiser during the calendar year. The sale is taxable.

3. Sales which constitute an integral part of a business even though the sale of such tangible personal property is not the primary business of the seller (as the sale of repossessed property by a finance company).

4. The sale of by-products, waste, scrap and other obsolete and used equipment by a person engaged in a business, when sales are regularly made to employees or to the public to dispose of these items.

D. Garage sales and flea markets. A "garage sale" is a sale by a person or persons selling their excess personal belongings in a garage, porch, backyard, basement, etc. If the items sold have not been collected or purchased for the purpose of resale, the sales are isolated or occasional. If a person collects or

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purchases items for resale, he is deemed to be in business, and must obtain a sales and use tax permit and collect and remit tax on his sales of taxable items.

A gathering of vendors selling their merchandise at one location is commonly referred to as a "flea market". A flea market differs from a garage sale in that the vendors collected or purchased or manufactured the merchandise with the intention of reselling it. Each vendor at a flea market must obtain a sales and use tax permit and collect and remit tax on his sales of taxable merchandise.

A fee paid for leasing an area in a flea market is not a lease of personal property and is not taxable.

Admissions to flea markets are not taxable.

E. Sales by non-profit organizations. Sales of tangible personal property by non-profit organizations at bazaars, fairs, picnics, rummage sales or similar events will be deemed to be isolated or occasional if two non-consecutive days of such sales or less are held in any calendar year. If more than two sales are held in any calendar year or if a sale is held for two or more consecutive days, all sales are subject to tax. If tangible personal property is sold at such an event by a person, holding a sales and use tax permit, other than the non-profit organization, the sales by such person would be taxable.

A sale made by a non-profit organization at which only items exempt from tax under Minn. Stat. § 297A.25, subd. 1(a), (b) or (g) are sold shall not be included as an event for purposes of this clause (e).

Example 1. Non-profit Organization "X" conducts sales on two nonconsecutive days during the calendar year, the first on January 15, 1971, and the second on February 18, 1971. As no more than two such events of one day's duration each occurred during the calendar year, the sales made at such events are exempt as isolated or occasional sales.

Example 2. Non-profit Organization "Y" conducts a sale on April 15 and 16, 1971. "Y" does not conduct any other sales during 1971. As this event was longer than one day's duration, the sales made constitutes sales in the regular course of business, and "Y" is required to secure a sales and use tax permit, collect the tax due and remit same to the Commissioner, unless such sales are otherwise exempt under the Sales and Use Tax Law.

Example 3. Non-profit Organization "Z" conducts a sale on March 15, 1971, and another sale on May 10, 1971. "Z" reports no gross receipts, pursuant to the provisions of this clause (e) exempting such sales. On December 5, 1971, "Z" conducts a sale of property taxable under the Sales and Use Tax Law. Consequently, sales made at this event, as well as the previous sales made on March 15, 1971, and May 10, 1971, are non-isolated sales, and "Z" is required to secure a sales and use tax permit and to report the gross receipts from all three events that occurred during the calendar year.

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Example 4. Same facts as in Example 3, except that the sale by Non-profit Organization "Z" held on December 5, 1971, is a bake sale at which only exempt food products for home consumption are sold. The bake sale held on December 5, 1971, does not constitute a sales event; consequently, Non-profit Organization "Z" has not exceeded the limitation of two events of a single day's duration, and the previous sales will be deemed to be isolated or occasional sales.

F. Occasional meals. While the furnishing, preparing or serving of meals or drinks for a consideration generally constitutes sales within the meaning of the Sales and Use Tax Law, such sales are not sales of tangible personal property and thus do not come under the exemption for "the isolated or occasional sale of tangible personal property" provided in Minn. Stat. § 297A.25, subd. 1(k). However, occasional meals served by charitable or church organizations are specified in the statute as not being included in the meaning of "sale" and accordingly are exempt from tax. See regulation Tax S&U 108, clause (e), regarding the status of meals by charitable or church organizations.

G. Admissions. The granting of the privilege of admission to places of amusement or athletic events and the privilege of use of amusement devices is a taxable sale under Section 297A.01, Subd. 3(d). However, such sales are not sales of tangible personal property and thus do not come under the exemption for "the isolated or occasional sale of tangible personal property" provided in Section 297A.25, Subd. 1(k).

Tax S&U 412 Rolling stock. The sales and use tax does not apply to sales of rolling stock to, and the storage, use or other consumption of such property by railroads, freight line companies, sleeping car companies and express companies which are subject to gross earnings taxes in lieu of ad valorem taxes.

For purposes of this exemption, "rolling stock" includes all portable or moveable equipment, apparatus or machinery which moves on railroad tracks and all parts necessary for repair and maintenance of such property.

Fuels, lubricants, cooking utensils, glassware, flatware, linens and all other items used or intended for use with rolling stock, that are not an integral part of such equipment, are not included within the meaning of "rolling stock".

Motor vehicles and other portable or moveable equipment which is not intended for use on railroad tracks shall not be included within the meaning of rolling stock.

Tax S&U 413 Airflight equipment. The sales and use tax does not apply to sales of airflight equipment to and the storage, use or other consumption of such property by airline companies which are subject to tax under the provisions of Sections 270.071 through 270.079.

For purposes of this exemption, "airflight equipment" includes airplanes, aircraft communications and navigational equipment, flight crew equipment, flight simulators, hydraulics and all parts that are affixed thereto and become

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component parts thereof including hydraulic fluids, parts necessary for the repair and maintenance of such equipment, and all property subject to assessment under Sections 270.071 through 270.079.

"Airflight equipment" shall not be deemed to include lubricants, repair equipment and tools, ramp equipment, or other equipment such as broilers, dishes, food boxes, thermos jugs, blankets, etc.

Tax S&U 414 Telephone central office telephone equipment. The sales and use tax does not apply to sales and use of telephone central office telephone equipment used in furnishing intrastate and interstate telephone service to the public.

"Telephone central office telephone equipment" shall include electrical instruments, apparatus and equipment with central office functions, regardless of location, which is used in switching or in transmitting traffic and operating signals. It shall also include equipment and apparatus used for testing and training.

"Telephone central office telephone equipment" as defined above shall include all items of equipment or apparatus included in either Account 221 or 234 and P.B.X. boards of 100 lines or less included in Account 231 of Title 47, Telecommunications, Chapter 1, Part 31, Uniform System of Accounts, Class A and Class B telephone companies, of the Federal Communications Commission's Rules and Regulations as revised through March, 1971, except as provided below. "Telephone central office telephone equipment", however, shall include no item of equipment or apparatus not included within either Account 221 or 234, except P.B.X. boards specified above.

"Telephone central office telephone equipment" shall not include desks and tables not equipped with central office equipment, kitchen and dining room equipment, chairs, cabinets, ladders, small tools, typewriters, portable electric fans and the like which do not form an integral part of the central office equipment and apparatus, whether or not such items may be included within Account 221 or 234.

Since the exemption is conditioned upon the use of such equipment in the furnishing of telephone service to the public, persons claiming such exemption shall apprise vendors through use of an appropriate exemption certificate of the fact that the equipment is intended for such use.

The Sales and Use Tax does not apply to repair parts purchased for use in the repair or modification of "telephone central office telephone equipment" as specified above.

Tax S&U 415 Charitable, religious, and educational organizations.

A. *In general.* Minn. Stat. § 297A.25, subd. 1(p), exempts from sales and use tax, "the gross receipts from the sale of tangible personal property to, and storage, use or other consumption of such property by, any corporation,

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society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes." if the property is to be used in the performance of charitable, religious or educational functions. . ." The property purchased must be used in the performance of the charitable, religious or educational function of the tax exempt organization. For example, furniture purchased by a church for use in its parsonage is exempt since it is purchased for use by persons that administer religioous activities to the congregation. These items are not purchased for the personal use of any one specific person but rather for the operation of a religious organization. However, purchases of bingo equipment such as bingo cards and accessory bingo equipment by churches for fund raising are taxable as being property purchased for use in non-religious functions.

Although the furnishing of meals, admissions and lodgings are defined in Minn. Stat. 297A.01, subd. 3(c), (d) and (e) as sales, they are not sales of tangible personal property and cannot be exempted under Minn. Stat. § 297A.25, subd. 1(p), when purchased by a charitable, religious or educational organization.

For purposes of brevity and convenience, charitable, religious or educational purposes will be referred to as "exempt purposes", and an organization, society, association, foundation or institution organized and operated exclusively for "exempt purposes" will be referred to as an "exempt organization."

B. Charitable defined. "Charitable" is used in its generally accepted legal sense and includes relief of the poor, under-privileged, distressed and defective, the care of the sick, the infirm or the aged; erection or maintenance of public buildings and monuments; lessening of the burdens of government; lessening of neighborhood tensions; elimination of prejudice and discrimination; defense of human and civil rights secured by law; and combating of community deterioration and juvenile delinquency.

C. Religious defined. "Religious" refers to an institution that conducts worship services at regular intervals in a structure owned, leased or borrowed for that purpose, and organizations affiliated with or related thereto, which exist exclusively for the furtherance of the religious purposes of the institution.

D. Educational defined. "Educational" relates to the instruction or training of individuals to improve or develop their capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. Examples of educational institutions are primary and secondary schools, colleges and universities, and professional and trade schools having a regularly scheduled curriculum, a regular faculty and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on. Educational organizations include P.T.A., Boy Scouts, Girl Scouts, Camp Fire Girls, Y.M.C.A., Y.W.C.A., and youth athletic and recreational programs such as Little Leagues. Other educational and institutions include museums, zoos, planetariums, symphony orchestras and other similar organizations.

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An organization may be educational even though it advocates a particular position or viewpoint, so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.

E. Organization and operational tests. In order to be an "exempt organization", and organization must be organized and operated exclusively ffor "exempt purposes." The following tests will be used in determining whether or not an organization qualifies as an "exempt organization":

1. An "exempt organization" may not be organized or operated for the purpose of making a profit which inures to the benefit of any private shareholder or individual. The organization must be able to demonstrate by its articles of incorporation or if unincorporated, a certified copy of its constitution and by-laws, and its financial statements that:

a. No part of the net earnings of its activities inures to the benefit of any private shareholder, or individual member; and, no part of its assets will directly or indirectly be transferred, in the event of dissolution of a corporation or termination of an unincorporated association to its members, founders or shareholders.

b. It is supported and maintained at least in part by benevolent contributions; that is, one of its sources of support is donations, income from donations, and contributions and dues of members for which they receive no direct benefit.

The fact that an organization may receive voluntary contributions from those who benefit from its activities will not necessarily prevent its being an "exempt organization." But if it is determined that the services rendered by the organization are conditioned upon the receipt of a "contribution" the services rendered may be regarded as a commercial activity.

The fact that an organization is nonprofit does not necessarily make it an "exempt organization." The following are examples of nonprofit organizations which do not qualify for exemption: organizations attempting to influence legislation or participating in political campaigns; fraternal or beneficial societies; clubs organized and operated for pleasure, recreation or other similar purposes; and volunteer employee benefit associations. Thus, such organizations as Masons, Knights of Columbus, B'nai B'rith, League of Women Voters, Chambers of Commerce, retail and credit trade associations and American Legion are not "exempt organizations".

2. If an organization, by the terms of its articles, has purposes that are broader than the "exempt purposes" specified in Minn Stat. 297A.25, subd. 1(p), the fact that its actual operations have been exclusively in furtherance of "exempt purposes" is not sufficient to make it an "exempt organization." Similarly, an organization that is organized exclusively for "exempt purposes" is not an "exempt organization" if significant part of its operations are not in furtherance of its "exempt purposes."

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3. An organization is not an "exempt organization" if it is either organized or operated to make substantial attempts to influence legislation or intervene or participate in a political campaign (including the publishing or distributing of statements).

4. An "exempt organization" must serve a public rather than a private interest. Thus, to gain exemption an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests. An organization which is organized or operated primarily for the benefit of its individual nonexempt members rather than for the benefit of the general welfare does not qualify for exemption.

5. The assets of an "exempt organization" must be dedicated to an "exempt purpose." An organization is not an "exempt organization" if its net earnings are used in whole or in part to the benefit of shareholders or individuals who have a personal or private interest in the activities of the organization.

6. Effective July 1, 1977, an exempt organization will lose its status as an exempt organization under Minn. Stat. § 297A.25 subd. 1(p) if the employer, who employs 10 or more individuals who are residents of the state, fails to provide qualified health insurance for its employees pursuant to Laws of Minnesota 1976, Chapter 296.

F. Derivative organizations. An organization may qualify derivatively for exemption if its members are "exempt organizations" and the organization is organized and operated exclusively to assist its member organizations in carrying out their exempt purposes.

G. Exemption certificates. A religious or educational organization may furnish properly completed Certificates of Exemption, Forms ST-3, in making exempt purchases of tangible personal property. A charitable organization must apply for and receive a Certificate of Exempt Status, Form ST-17, and furnish copies of that certificate in making exempt purchases of tangible personal property. As a matter of convenience for themselves and their suppliers, religious and educational organizations may also apply for and receive Certificates of Exempt Status.

The Application for Certificate of Exempt Status, Form ST-16, is available upon request from the Sales and Use Tax Division. The application should be fully executed and submitted with the necessary supporting documents. No charitable organization making purchases after July 1, 1969, shall be entitled to make such purchases exempt from the sales and use tax unless a Certificate of Exempt Status has been issued by the Commissioner of Revenue.

If an organization is organized and operated exclusively for an "exempt purpose", exemption will be granted to the organization regardless of the pur-

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pose indicated in its Application for Certificate of Exempt Status. For example, if an organization claims exemption on the grounds that it is "educational", exemption will not be denied if it is, in fact, "charitable".

Form ST-17
(Rev. 1-1-77)

State of Minnesota
Department of Revenue—Sales and Use Tax Division
Centennial Office Building—St. Paul, Minnesota 55145

CERTIFICATE OF EXEMPT STATUS—EXEMPT ORGANIZATION

Under the provisions of Section 297A.25, Subdivision 1 (p) of the Minnesota Sales and Use Tax Law, the organization whose name appears below is certified to be exempt from sales and use taxes applicable to purchases, rentals and leases of tangible personal property to be used solely and exclusively in the performance of charitable, religious or educational functions by that organization.

	Certificate No. E S
	Date Issued

Commissioner of Revenue

This certificate is valid until revoked by the Minnesota Department of Revenue.

By_____
Sales and Use Tax Division

The exemption does not apply to purchases of meals, lodging or tickets of admission.

Tax S&U 416 Caskets, burial vaults, urns for cremains and memorials.

(a) Caskets, burial vaults and urns for cremains exempt. The gross receipts from sales of caskets, burial vaults and urns for cremains, used for human burial, are not subject to tax, whether made by a distributor to an undertaker or cemetery association, or by an undertaker or cemetery association to the general public. No exemption certificate need be offered by the purchaser.

(b) Exemption not applicable to memorials.

(1) Sales of tombstones, markers or other memorials and the foundation upon which such tombstones, markers and other memorials are placed,

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including the material used in setting the memorials in the cemetery, are considered sales of tangible personal property, and subject to the Sales and Use Tax Law. Memorial dealers are the retailers of such property. The tax applies to the entire amount charged, without deduction therefrom of the production cost of cutting, shaping, polishing or lettering the memorial. However, charges for inscriptions upon a stone subsequent to its erection, constitute receipts from personal services, which, if stated separately, are deductible from the total charge.

(2) If the seller agrees to install the memorial in a cemetery, the charge for transporting the memorial to the cemetery and for the labor of setting the memorial in the cemetery are not taxable if such charges are stated separately. If the transportation or installation labor charges are not separately stated, the tax is applicable to the entire sales price.

(3) Where a cemetery constructs the foundation upon which a memorial is to be placed, and collects the charges therefor from the memorial dealer, who then either collects that amount as a separate charge from his customer or includes it in the total charge for the memorial, the memorial dealer is the retailer of the foundation and must collect and remit the tax on the charges made therefor. The cemetery, under such circumstances, is merely acting for the memorial dealer.

(4) In the event that the cemetery collects the charges for foundations directly from customers of the memorial dealer, the cemetery is the retailer and must collect and remit the tax with respect to the charges made for the completed foundation.

(5) Sales to memorial dealers and cemeteries of materials, including sand, gravel, cement and supplies, which are used in the processing of tombstones, markers or other memorials, and the erection of foundations on which finished tombstones, markers, or other memorials are placed, and which become component parts thereof, are exempt as sales used in industrial production. Sales to memorial dealers and cemeteries of tools, equipment and supplies which do not become component parts of finished foundations, tombstones, markers or other memorials are taxable. (See Section 297A.25, Subd. 1(h)).

Tax S&U 417 Disabled veterans–purchases of automobiles and other conveyances. Section 297A.25, Subd. 1(s) provides exemption for the gross receipts from the sale of an automobile or other conveyance to a disabled veteran if the purchaser is assisted by a grant from the United States in accordance with Title 38 United States Code, Section 1901, as amended.

This exemption is effective for the purchase of vehicles and the purchase of any qualifying adaptive equipment purchased with Federal assistance after June 30, 1971. The exemption shall be applicable for a vehicle as well as adaptive equipment even though the grant was limited to assistance in purchasing only adaptive equipment for such vehicle.

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To effect the exemption, the following procedure should be followed:

(1) Have VA Form 21-4502 (Application for Automobile or Other Conveyance) or VA Form 10-1394 (Application for Adaptive Equipment–Motor Vehicle) completed in full by all parties concerned.

(2) When the completed VA Form 21-4502 or VA Form 10-1394 and copies of the seller's invoices are furnished to the Veterans Administration, the appropriate Veterans Administration official will stamp and sign one copy of the seller's invoice certifying that the purchase was made under the provisions of Title 38, Section 1901, as amended, and return it to the seller with the check in payment of the allowable amount. The seller should keep the copy of the invoice for his records, to verify that the sale was properly exempt.

Effective January 1, 1972, sales of automobiles or other conveyances (which are subject to Minnesota registration) are no longer subject to Sales and Use Tax but are subject to the Motor Vehicle Excise Tax under the provisions of M.S. Chapter 297B. A disabled veteran purchasing such items with adaptive equipment after December 31, 1971 with funds provided by the Veterans Administration under the provisions of 38 United States Code, Section 1901 as amended, should attach to the Motor Vehicle Purchaser's Certificate upon registration either a copy of VA Form 21-4502 or VA Form 10-1394 with all sections of the form completed. The procedure for obtaining exemption for other conveyances that are not subject to the Motor Vehicle Excise Tax and for adaptive equipment remains the same as in (1) and (2) above.

Tax S&U 418 Aircraft Commercial Use Permit.

(a) An aircraft dealer who is licensed in accordance with Minnesota Statutes, Section 360.63, may make application, under the provisions of Section 360.654, for an Aircraft Commercial Use Permit. Application for the Aircraft Commercial Use Permit, Form ST-22, is available upon request from the Department of Revenue. To obtain an Aircraft Commercial Use Permit, the dealer must complete an application, Form ST-22, for each aircraft for which he needs a permit. There is a $20 fee for each permit applied for, and the permit will be issued only for an aircraft purchased after June 4, 1971.

(b) The permit entitles the dealer to use the aircraft, purchased exempt for the purpose of resale, for commercial purposes without payment of the use tax which otherwise would be due. It is not necessary for a dealer who purchases an aircraft for the purpose of resale to obtain an Aircraft Commercial Use Permit if the sole use is rental without an operator or demonstration in efforts to sell.

(1) Commercial use includes any use of an aircraft in the normal course of business, such as charter service, freight transportation and flight instructions.

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(2) Commercial use does not include personal use of the aircraft. If an aircraft is put to any personal use, the dealer becomes liable for payment of the use tax.

(c) The Aircraft Commercial Use Permit may be obtained only for aircraft purchased for resale but used temporarily in revenue producing activities such as charter, instruction, crop spraying or similar activities. This does not include the aircraft that are capitalized and listed on depreciation schedules for income tax purposes. The capitalization of assets and depreciation thereof denotes the intention to use property other than for sales inventory purposes.

(d) Permit expiration. The Aircraft Commercial Use Permit expires one year from the date the aircraft is purchased, regardless of the date the permit is issued. The dealer becomes liable for the use tax for the month in which the permit expires, and the purchase price must be reported on line 4 of the dealer's Sales and Use Tax Return, Form ST-1. The Aircraft Commercial Use Permit must be returned with Form ST-1. No credit or refund is given for the $20 fee originally paid.

(e) Sale of aircraft. When the dealer sells the aircraft, the selling price must be included in his gross sales. The fact that the Aircraft Commercial Use Permit has not expired or that the dealer has reported and paid use tax on the aircraft has no effect on the taxability of the sale. The dealer must return the Aircraft Commercial Use Permit (unless previously returned) when he files his Sales and Use Tax Return for the month in which the sale was made. No credit or refund is given for the $20 fee originally paid.

(f) A facsimile of the authorized Aircraft Commercial Use Permit is reproduced as follows:

Form ST-23

Minnesota Department of Revenue—Sales and Use Tax Division
AIRCRAFT COMMERCIAL USE PERMIT

Permit Number	Date Issued	Dealer's Name
Federal Aircraft Registration Number N -	Permit Expiration Date	Dealer's Address
Make, Model, Year, Description of Aircraft	Dealer's Sales and Use Tax - Account Number	

DISPLAY THIS PERMIT CONSPICUOUSLY IN AIRCRAFT

This permit is ussed pursuant to authority contained in Minnesota Laws 1971, Chapter 740.

COMMISSIONER OF REVENUE

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Tax S&U 419 Disabled veterans—purchase of building materials. Section 297A.25, Subd. 1(u), of the Minnesota Sales and Use Tax Law provides exemption for the gross receipts from the sale and purchase of building materials after June 30, 1971, to be used in the construction or remodeling of a residence for a disabled veteran when the construction or remodeling is financed in whole or in part by the United States in accordance with Title 38 United States Code, Sections 801 to 805, as amended.

The exemption is not allowed when the building materials are sold to the contractor, subcontractor, builder or owner, but will be allowed to the recipient of the benefits provided in 38 United States Code, Sections 801 and 805, as amended, upon the filing of a claim for refund, accompanied by the following documents to substantiate the validity of such claim:

(1) copies of the Analysis and Review of Application for PH Grant (VA Form 26-4559), which is available from the regional VA office, and claimant's letter of approval, VA Form FL 26-38 (3072);

(2) copies of invoices or other evidence substantiating building material costs and payment of applicable sales taxes in the case of materials purchased directly by the claimant;

(3) copies of invoices or other evidence substantiating building material costs and payment of applicable sales taxes in the case of materials purchased by a contractor or a subcontractor.

The claim for refund shall be filed on Form ST-11dv, which form is available upon request from the Department of Revenue.

A claim must be filed within three years from the date the building materials were purchased. A claim will not be entertained for materials purchased prior to July 1, 1971. Interest shall be payable from the date of filing such claim.

Tax S&U 420 Textbooks.

(a) In general. Section 297A.25, Subd. 1(v), exempts the sale of textbooks which are prescribed for use in a course of study in a public or private school, college, university, business or trade school to regularly enrolled students. For the purposes of this regulation, the following words, terms and phrases shall have the meaning ascribed to them below:

"Textbooks which are prescribed for use in a course of study" are defined as any book or other printed instructional material which is specifically required for a course of study. Encyclopedias, dictionaries, and school supplies such as paper, pencils and folders are not included within this definition.

"Public school" is defined as one that furnishes courses of study, enrollment and staff that meet standards of the state board of education.

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"Private school" is defined as one which under the standards of the state board of education provides an education substantially equivalent to that furnished at a public school.

"Business and trade schools" are defined as those schools licensed pursuant to Section 141.25.

"College" is defined to include all professional schools, para-medical and other para-professional schools and nursing schools.

"Regularly enrolled student" is defined as one enrolled in a course of study at a qualifying educational institution with tuition, if required, currently paid. This definition includes correspondence, extension, full-time and part-time students.

(b) Criteria for determining taxability. As a general rule, the sale of all textbooks shall be regarded as taxable. However, if a purchaser certifies that the book to be purchased is specifically required for a course of study at a qualifying educational institution and that he is a regularly enrolled student at such institution, the book may be purchased exempt. Such certification must contain the student's signature, the date, the purchase price of the exempt book and the following statement:

"I HEREBY CERTIFY: That I am a regularly enrolled student in a course of study at a public or private school, college, university, business or trade school, and that the textbooks purchased exempt on this date are specifically required for a course of study at such educational institution."

A vendor receiving such certification from a purchaser is relieved from the responsibility of collecting the tax, provided he accepts the certification in good faith and retains the certification in his records.

Compliance with this regulation may consist of a listing of student's signatures, purchase dates, and purchase amounts entered beneath the certification statement.

Tax S&U 421 Taconite plant construction and expansion exemptions.

A. General. Minn. Stat. § 297A.251 exempts from the sales and use tax materials, supplies and equipment used or consumed in constructing or incorporated into a new taconite plant or the expansion of an existing taconite plant, if such expansion results in an increase in production capacity of at least 10 percent. Included in this exemption is the lease of equipment used in construction. In order for the exemption to be applicable, the following criteria must be met:

1. The construction must have been started prior to February 1, 1975.

2. The materials, supplies or equipment must have been purchased after October 30, 1971.

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3. The materials, supplies or equipment must have been used or consumed in connection with such construction or incorporated into the new plant or plant expansion before July 1, 1978.

4. In the case of leased equipment, the lease payments must have been made for periods beginning after October 30, 1971 and ending prior to July 1, 1978.

5. The purchaser must be the owner, a construction contractor or construction sub-contractor.

B. Property exempt.

1. All tangible personal property physically incorporated into the construction such as bricks, cement, steel beams, electrical supplies, glass, woodwork, paint and paint supplies, pipes and valves, aluminum sheathing, wood and composition sheathing, lumber, plastics, roofing and wallboards, lighting fixtures, plumbing and bathroom fixtures, furnaces, boilers and heating units for space heating, prefabricated cabinets and central air conditioning units.

2. Materials and supplies not incorporated in construction but consumed with construction. Included in this category are items such as lubricants, oxygen and acetylene, items used by field offices and shops including electricity, fuel, office supplies, toilet and washroom supplies.

3. Equipment purchased for and used in construction of the plant. In the case of equipment used in the construction of a taconite plant, which equipment meets all of the criteria specified in clause (a) and which has a useful life beyond the date of completion of the construction, or July 1, 1978, whichever occurs earlier, and which is thereafter not incorporated into the plant, a use tax shall be due on a portion of the purchase price in the ratio that the estimated remaining useful life bears to the estimated useful life at the time of acquisition. The period of the estimated remaining life shall commence with the date the use of the equipment on the plant is discontinued or July 1, 1978, whichever is earlier.

4. Equipment which is part of the operational facility but not incorporated into the construction. Examples of items included in this category are: drilling machinery, bulldozers, draglines, haul trucks, portable pit offices, dump shacks, office equipment, desks, portable lockers, warehouse shelving, fork lifts, vacuum cleaners, lunch room tables and chairs, etc. In the case of a plant expansion such items shall be exempt only to the extent related to the expanded facility. Equipment purchased for replacement of equipment in or for the previously existing plant does not come within the exemption.

C. Motor vehicles. Motor vehicles for which registration is required under the provisions of Minn. Stat. ch. 168 are not included within the exemption. Motor vehicles not subject to such registration may be exempt if qualified under preceding clauses (a) and (b).

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D. Application for taconite plant material exemption. To qualify for the exemption from sales or use tax on purchases of tangible personal property or lease of equipment, made pursuant to contracts for construction of a new plant or the expansion of an existing plant, a contractor or sub-contractor must file with the Sales and Use Tax Division a copy of the construction contract and an "Application for Taconite Plant Material Exemption," Form ST-7TP. Where an owner purchases or leases tangible personal property which he will incorporate into the construction of a new plant or expansion of an existing plant, a letter of application must be submitted to the Sales and Use Tax Division, unless the owner is the holder of a Direct Pay Permit. In the case of an approved application, an exemption certificate and number will be issued to the applicant.

Tax S&U 422 Senior citizen organizations.

A 1974 amendment to Minn. Stat. § 297A.25, subdivision 1(p) effective August 1, 1974, allows an exemption to any senior citizen group organized and operated exclusively for pleasure, recreation and other non-profit purposes, no part of the net earnings of which inures to the benefit of any private shareholder. Senior Citizen groups are eligible for exempt status if they meet two requirements. One, they must be formally organized for pleasure, recreation or other non-profit purpose. Two, they must limit their membership to senior citizens who have attained the age of 65 years or over. To receive exempt status certificate (ST-17) a senior citizen group must make application on Form ST-16.

Tax S&U 423 Residential Heating Fuels.

A. In general, Minn. Stat. 297A.25, Subd. 1(x) exempts from sales and use tax, "the gross receipts from the sale of residential heating fuels in the following manner: 1. all fuel oil, coal, wood, steam, propane gas, and L.P. gas sold to residential customers for residential use; 2. natural gas sold for residential use to customers who are metered and billed as residential users and who use natural gas for their primary source of residential heat, for the billing months of November, December, January, February, March and April; 3. electricity sold for residential use to customers who are metered and billed as residential users and who use electricity for their primary source of residential heat, for the billing months of November, December, January, February, March and April."

Natural gas or electricity sold for residential use to customers, who are metered and billed as residential users and who use natural gas or electricity for their primary source of residential heat, is exempt from the sales and use tax for the billing months of November, December, January, February, March and April after March 31, 1978. When gas or electricity is exempt as a heating fuel, all other gas or electricity used through the same meter shall also be exempt for the six month period.

All sales of fuel oil, coal, steam, propane gas and L.P. gas sold to residential customers for residential heating after March 31, 1978, are exempt from

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the sales and use tax. This exemption applies on a year-round basis. These fuels must be delivered to the residence in order to be exempt. All fuel oil, coal, steam, propane gas and L.P. gas delivered to a residence is assumed to be used for residential heating and exempt. All fuel oil, coal, propane gas and L.P. gas that is not delivered to a residence is taxable. Sales of firewood are exempt as residential heating fuel whether delivered or picked up by the customer. Sales of artificial fireplace logs are not exempt from the sales and use tax.

Exemption certificates may be required by the vendor to establish eligibility for the residential heating fuel exemption.

B. Description of terms. For purposes of this exemption, the following definitions shall be applicable.

1. "Residential use" means use for general household purposes including cooking and water heating. It does not include use in travel trailers, motor homes or other recreational vehicles. The use of fuel to heat fish houses is taxable since these are not regarded as residences.

Where a building, which houses both residential quarters and a commercial operation, contains one central heating plant for the entire building, heating fuels supplied to or for such heating plant shall be regarded as used for residential use if less than 50 percent of the square footage of the building is used for commercial operations.

2. "Residential customers" and "residential users" shall include persons billed for sales of residential heating fuel for single family homes, duplexes, townhouse units, condominium units or buildings, apartment units, apartment buildings, mobile homes, fraternity or sorority houses, and rooming houses.

3. The "billing month" for natural gas or electricity is the month the bill is dated regardless of when the service was rendered. Bills dated April, 1978, will qualify for the exemption. "Billing month" is the meter reading date if there is no date on the bill. If a utility uses a system of cycle billing and 12 revenue months per year, the "billing month" may be the utility's revenue month. In any event, each qualifying customer shall receive six months of service exempt from taxation.

4. The "primary source of residential heat" shall be that source which heats the largest square footage of floor space. Where a user heats the same area with two sources of heat, each using different fuels, such as a home heated by wood which also has an electric heating system, then the primary source of residential heat shall be that source which supplies more than any other source for the largest period of time during the heating season.

5. The effective date of this rule is April 1, 1978. Any tax on heating fuel previously collected on the basis of earlier rulings, inconsistent with this rule shall be refunded or credited by the vendors to their customers.

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C. Examples. The following are examples where a residence has more than one source of heat or where the residence is also used as commercial property.

Example 1. A. owns a building with a restaurant on the first floor, which he operates. A. lives in an apartment on the second floor. There is one central heating plant for the entire building, and the primary source of heat is natural gas. The basement is not used as part of the commercial operation. Since less than 50 percent of the square footage is used for commercial purposes, the exemption applies.

Example 2. B. heats his home with natural gas. B. adds an addition to his home, which is heated with electricity. The largest square footage of the floor space is heated with gas. Since only that fuel which provides the primary source of heat for the entire residence qualifies for the exemption, both fuels cannot be exempt. Here the electricity is taxable and the natural gas exempt because the primary source of heat for the entire residence is natural gas.

Example 3. C. owns and operates a resort. He has a home and four cabins which are heated by L.P. gas from one L.P. gas tank. The four cabins constitute a commercial business activity. There is only one common source of heat. The fuel supply to the common heating plant is not regarded as used for residential use if the square footage of the four cabins exceeds that of the home. In determining the square footage of commercial use, the seasonal use must also be considered. Assume a resort owner has a 1,600 square foot home and four rental units of 750 square feet each that are available for rent six months of the year. In computing the square footage for commercial use, 4 X (1/2 of 750) or 1,500 square feet is for commercial use; and as 1,600 square feet is for residential use, the heating fuel is exempt.

Example 4. D. is a dentist, who has his dental office in his home. D's home is heated with fuel oil. The fuel is exempt if the office occupies less than 50 percent of the square footage of the home.

Example 5. A person uses fuel oil to heat his home, but uses electricity to provide additional heat in the basement. What is exempt? All fuel oil delivered to the residence is exempt starting April 1, 1978, but as the electricity is not the primary source of heating the residence, it is taxable.

Example 6. L.P. gas dealer delivers gas to individual homes at a mobile home park. How can he determine if the L.P. gas is used for heating? L.P. gas delivered to a residential customer is deemed to be for heating purposes and exempt.

Example 7. Customer heats his residence with natural gas and is on a budget plan with a local utility. Will his budget payments be less for the months of November through April? No, the utility does not pay the sales tax on the monthly payments, but they pay in on actual consumption. Your monthly payments would remain the same, but you would not be paying a sales tax on gas during the six-month period.

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Example 8. Resort uses L.P. gas to heat the owner's residence and five rental units from the same tank. At the end of the season, the rental units are closed down and only the owner's residence consumes L.P. gas. Should the rental units which are not operational during the winter be included in determining if the customer is a residential user? Yes, but the seasonal use of the rental units is considered in determining if the commercial use exceeds 50 percent (see Example 3 above).

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CHAPTER FIVE: Tax S&U 500-599
RETURNS, ASSESSMENTS AND COLLECTIONS

Tax S&U 500 When tax is due.

(a) Generally, sales and use taxes imposed under law are due and payable at the office of the Commissioner monthly on or before the twenty-fifth day of the month immediately following the month in which the taxable event or events occurred.

(b) In addition, under authorization granted to him by law (see Section 297A.26, Subd. 1), the Commissioner may authorize other reporting periods. Such authorizations may be granted provided:

(1) The person desiring to file on other than a monthly basis must file Form ST-12, Application to File Quarterly or Annual Minnesota Sales and Use Tax Returns, with the Sales and Use Tax Division;

(2) The application for quarterly or annual returns must be filed not later than thirty days immediately preceding the first day of a quarter period beginning on either January 1, April 1, July 1 or October 1.

(3) The person applying for authorization to file on a quarterly basis must have had average sales and use tax liability of less than $100.00 per month for the six-month period preceding the period for which the change in filing is requested. The person applying for authorization to file an annual return must have had an average sales and use tax liability of less than $10.00 per month for the preceding one-year period.

Where authorization to file on other than a monthly basis has been granted by the Commissioner, the tax due thereunder shall be paid at the office of the Commissioner on or before the twenty-fifth day of the month immediately following the close of the authorized period.

(c) Authorizations granted by the Commissioner to file sales and use tax returns, either on a quarterly or annual basis, may be revoked if:

(1) The person granted such authorization is either delinquent in filing his return or in paying the tax due;

(2) Such person's tax liability exceeds $300.00 for any subsequent quarter where the filing of quarterly returns has been authorized, or where such person's tax liability exceeds $120.00 for any subsequent calendar year where an annual return has been authorized; or

(3) Where the Commissioner determines that the procedures authorized under this regulation unduly jeopardize the orderly and efficient administration of the Sales and Use Tax Law.

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(d) In the event that authorization to file returns and pay the tax due thereon, either on a quarterly or annual basis, is revoked by the Commissioner, the person whose authorization has been so revoked shall thereafter be required to file his return and pay the tax due thereon on a monthly basis in accordance with this regulation.

In the event that a person authorized to file on a quarterly or annual basis ceases to engage in a kind of business which requires that he file returns under the Sales and Use Tax Law, such person shall file a final return by the twenty-fifth day of the month following the discontinuance of such business.

Tax S&U 501 Uncollectible debt deduction.

(a) Ordinarily, a deduction for bad debts is allowed only for a person who is reporting on the accrual method of accounting for sales and use tax purposes. However, if a cash basis taxpayer accepts an unsecured check in payment for a sale, reports the sale, and subsequently determines that the check is uncollectible, he is entitled to an uncollectible debt deduction. Uncollectible debts (commonly referred to as bad debts) shall be recognized as a deduction for sales tax purposes only when given recognition by a direct charge-off on the accounting records of the retailer. Consequently, no anticipatory or statistical method of estimating future bad debts will be allowed by the Commissioner.

Example. Retailer uses the "reserve method" of accounting for bad debts; that is, periodically he estimates the value of accounts receivable that will become uncollectible. For the month of September, the account books reflect bad debt expenses of $1,000.00 and a corresponding increase in the Reserve for Bad Debts Account. Accounts Receivable actually charged off during this month were $800.00 with a corresponding decrease in the Reserve for Bad Debts Account. The bad debt deduction for sales tax purposes is $800.00.

(b) Where a debt becomes uncollectible, either in whole or in part, in a reporting period subsequent to that in which the transaction that gives rise to the bad debt occurs, the retailer may deduct such bad debt against the gross receipts for the reporting period in which the bad debt is determined to be uncollectible in accordance with the following rules:

(1) Where the uncollectible bad debt arose in respect of a sale required to be included in gross receipts, subject to a tax imposed under the Sales and Use Tax Law, the entire amount of the debt remaining uncollected shall be allowed as a deduction;

(2) Where the uncollectible debt arose in respect of a sale partly subject to the tax imposed under the Sales and Use Tax Law, and partly exempt thereunder, the amount of the uncollectible debt allowed as a deduction shall be an amount derived by multiplying the uncollectible debt by the percentage that the taxable sale bears to the total sales;

(3) Where the uncollectible debt arose in respect of two or more sales

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made at successive intervals, payments made prior to the date the debt became uncollectible shall be applied, first to the earliest sale upon which there is an unpaid balance, and to following sales in successive order.

Example 1. "S", a vendor of office furniture, sells five desks to "C" at $200.00 per desk on January 15, 1968. "S" is on the accrual basis and includes in his gross receipts for January, 1968, the sales made to "C". Subsequently, "C" makes payments of $400.00. In June, 1968, "C" is unable to make further payments. "C" thereafter, by a "common law composition", makes a pro rata settlement with his creditors. "S" receives a final payment of $400.00 in November, 1968. The remaining balance of $200.00 is deemed uncollectible at that time. "S", in reporting his gross receipts for the month of November, will be allowed to deduct as a bad debt the $200.00 balance remaining uncollected.

Example 2. Electric Power Company furnishes power to Industrial Production Company. Of the electric power so furnished, approximately sixty percent is used in the productive process and forty percent is used for space heating, lighting and air conditioning the production and office premises. Industrial Production Company files a voluntary petition in bandruptcy on March 15, 1968. At that time, it owed Electric Power Company $3,000.00 for power furnished. Electric Power Company had included in its gross receipts $3,000.00, which were reported on an accrual basis, and had deducted $1,800.00 as exempt sales, leaving a net of $1,200.00 of taxable electric power services. At the termination of the bankruptcy proceedings in February, 1969, Electric Power Company received a distribution of $1,600.00. The uncollectible debt Electric Power Company is entitled to deduct on the return for the month of February, 1969 is computed as follows: From the total due of $3,000.00, there is subtracted $1,600.00, representing the amount paid to Electric Power Company in February, 1969. This leaves a balance of $1,400.00 uncollectible. This amount is multiplied by a fraction, the numerator of which is the amount taxable, $1,200.00, and the denominator of which is the total amount charged for power; that is, $3,000.00.

Thus, $1,400 X $\frac{\$1,200}{\$3,000}$ = $560.00, the amount allowable as a deduction.

Example 3. Supplier, who is on the accrual basis, sells Contractor-Retailer building supplies on March 15, 1968 for $20,000.00. At that time, there was no debt due Supplier from Contractor-Retailer. As these supplies were to be used by Contractor-Retailer in the alteration of real property, the sale is taxable. On April 5, 1968 Contractor-Retailer purchases tangible personal property for resale in the amount of $8,000.00 from supplier and gives to the latter an exemption certificate. On April 10, 1968 Contractor-Retailer purchases an additional $3,000.00 of building supplies to be used in his contracting activities. This last transaction represents a taxable sale. Contractor-Retailer makes payments to Supplier during March, April and May of 1968 totaling $8,000.00. Thereafter, Contractor-Retailer is unable to meet his obligations. An out-of-court settlement with his creditors is reached, and on September 1, 1968, Supplier is paid $10,000.00 representing final settlement of his claims.

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Supplier will be entitled to deduct from the amount of gross receipts he reports for the month of September, 1968 uncollectible accounts computed as follows:

March 15, 1968 taxable sales	$20,000
Payments received subsequently (total)	18,000
Balance due	2,000
April 10, 1968 taxable sales	3,000
Total uncollectible debt allowed as deduction on Supplier's September, 1968 return	$ 5,000

The $8,000.00 debt due to Supplier in respect to the April 5, 1968 transaction is non-taxable and may not be deducted subsequently.

(c) In the event that the Seller is entitled to a bad debt deduction in excess of the amount he is required to report for the month in which the debt is determined to be uncollectible, the balance of the deduction may be utilized in a subsequent month.

Example. Assume in Example 3 above that, for the month of September, 1968, Supplier was required to report $4,000.00 in gross receipts before taking a deduction for the uncollectible debt of $5,000.00. He would be entitled to deduct the remaining $1,000.00 in a subsequent month.

(d) In the case of repossessions, a bad debt deduction is allowable only to the extent that the pro rata portion of all payments and credits, including the wholesale value of the repossessed article, attributable to the cash sales price of the merchandise is less than the net contract balance (after excluding unearned insurance and finance charges) at the date of repossession.

One of the prerequisites in computing the loss on repossessed merchandise is determining the wholesale value thereof. In establishing the wholesale value on repossessed merchandise such as jewelry, furniture, appliances, etc., each case will have to be considered on its own merits. Generally, the taxpayer will be able to use the amount at which the merchandise is brought back into resale inventory.

Tax S&U 502 Returns and records.

(a) Sales and use tax return. Any person to whom the Commissioner has issued a permit under Sections 297A.04, .05 and .06, shall file the Form ST-1, Sales and Use Tax Return, prescribed by the Commissioner. Form ST-1, and instructions issued as a guide thereto, contain all the information required in order to complete the return. In accordance with Section 297A.27, Subd. 1, the form contains a statement to the effect that it is made under the penalties of criminal liability for wilfully making a false return. The return must be signed either by the person required to file it or by any person authorized by him to do so.

(b) Consumer's use tax return. Any person required to file a use tax

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return under Section 297A.27, Subd. 2, and who has not been issued a sales and use tax permit, shall file a return on Form UT-1, Consumer's Use Tax Return, on or before the twenty-fifth day of the month immediately following the month in which the property subject to use tax was first brought into Minnesota.

(c) Consolidated returns permitted. Where the person required to file a return has two or more places of business at which he engages in transactions subject to tax, he may elect to file a consolidated return, Form ST-1 (CON), Consolidated Sales and Use Tax Return, for all such places of business under the following conditions:

(1) He has been granted a sales and use tax account number by the Commissioner; and

(2) He furnishes to the Commissioner a list containing the business name and address and reporting information specified in clause (e) below for each separate place of business; and

(3) He makes available at the address used by him on Form ST-1 (CON), the information pertinent to each separate place of business in order that the Commissioner may be able to perform a proper audit with respect to the return so filed.

(d) Time and place of filing. All tax returns shall be filed at the office of the Commissioner on or before the twenty-fifth day of the month immediately following the month for which such taxes are due, unless authorization has been granted to the person required to file either on a quarterly or annual basis. Where a quarterly or annual filing is authorized, the return is required to be filed at the office of the Commissioner on or before the twenty-fifth day of the month immediately following the close of the period authorized. If any return required under the provisions of the Sales and Use Tax Law becomes due upon a Saturday, Sunday, or legal holiday, such return shall be considered timely filed if it is filed or received upon the next succeeding regular business day.

(e) Reporting requirements.

(1) All sales and use tax returns filed shall show total gross sales in any manner related to Minnesota business (not including the sales tax collected) on line one of the return without any exclusions except for the following:

(aa) charges for personal services rendered;

(bb) labor or service charges for installing or applying goods sold if separately stated;

(cc) charges for interest, financing and transportation incurred after the sale if separately stated;

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(cc) trade-in allowances;

(ee) cash discounts and cash or credit refunds on taxable property returned by customers;

(ff) installment payments on conditional or credit sales previously reported.

All of the above exclusions from gross sales shall be omitted from the amount entered on line one of the return. However, all such exclusions from line one shall be supported by the taxpayer's accounting records.

(2) All gross sales included in line one of the return but not subject to tax under the provisions of the Sales and Use Tax Law shall be itemized on the reverse side of the return. The total of itemized deductions shall be shown on line two of the return. The itemized deductions shall be supported by the taxpayer's accounting records and shall not be computed by subtracting line three from line one of the return.

(3) All sales revenues taxable under the provisions of the Sales and Use Tax Law shall be shown on line three of the return, and such amount shall be computed by subtracting line two (total gross sales not subject to tax) from line one (total gross sales).

(4) All purchases not previously taxed by the vendor, and subject to the tax under the provisions of the Sales and Use Tax Law shall be shown on line four of the return without regard to the location of the vendor.

(5) The sum of taxable sales plus taxable purchases from line four shall be shown on line five of the return.

(6) The amount of tax due on the return shall be shown on line six and shall be computed by multiplying the amount on line five of the return by the prevailing tax rate.

(7) If an error was made by reporting more or less than the correct amount of tax in a previous period, an adjustment may be entered on line eight. A detailed explanation of such adjustment must be submitted with the return. The explanation must include the following:

(aa) Name;

(bb) Sales and Use Tax Account Number;

(cc) The period(s) in which the error was made;

(dd) Computation to arrive at amount of adjustment; and,

(ee) The reason(s) for the adjustment (attach pertinent supporting documents).

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Overpayments in excess of $500.00 may not be entered on line eight. Refunds of such overpayments should be requested by filing a Claim for Refund, Form ST-11.

(f) Records–general. Every seller, retailer, and person storing, using, or otherwise consuming in this state tangible personal property purchased from a retailer, and every lessor and lessee of tangible personal property for use in this state shall keep adequate and complete records showing:

(1) Gross receipts from sales or rental payments from leases of tangible personal property (including any services that are a part of the sale or lease) made within Minnesota irrespective of whether the seller or lessor regards the receipts as taxable or nontaxable.

(2) All deductions allowed by law and claimed in filing returns.

(3) Total purchase price of all tangible personal property purchased for sale or consumption or lease in Minnesota.

These records must include the normal books of account ordinarily maintained by the average prudent businessman engaged in the activity in question, together with all bills, receipts, invoices, cash register tapes, or other documents of original entry supporting the entries in the books of account as well as all schedules or working papers used in connection with the preparation of tax returns.

(g) Records–microfilm. Microfilm reproductions of general books of account, such as cash books, journals, voucher registers, ledgers, etc., are not acceptable in lieu of original records. However, microfilm reproductions of supporting records of details, such as sales invoices, purchase invoices, credit memoranda, etc., may be maintained providing the following conditions are met:

(1) Appropriate facilities are provided for preservation of the films for periods required.

(2) Microfilm rolls are indexed, cross-referenced, labeled to show beginning and ending numbers or beginning and ending alphabetical listing of documents included and are systematically filed.

(3) The taxpayer agrees to provide transcriptions of any information contained on microfilm which may be required for purposes of verification of tax liability.

(4) Proper facilities are provided for the ready inspection and location of the particular records including modern projectors for viewing and copying the records.

A posting reference must be on each invoice. Credit memoranda must carry a reference to the documents evidencing the original transaction. Docu-

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ments necessary to support claimed exemptions from tax liability, such as bills of lading and purchase orders, must be maintained in an order by which they readily can be related to the transactions for which exemption is sought.

(h) Records–EDP. "Records" are defined to include punched cards, magnetic tapes, magnetic disk packs and other machine-sensible data media used for recording, consolidating and summarizing accounting transactions and records within a taxpayer's electronic data processing system, and all such records are required to be retained so long as their contents may be material in the administration of any provision of the Sales and Use Tax Law. Any machine-sensible records which are clearly not material to the administration of this law need not be retained. The Commissioner shall decide the materiality of any such records, and if the materiality of any record is questionable, then such record shall be retained. It shall not be required that taxpayers retain the same data on two or more machine-sensible media, i.e., if the same data is first punched into cards and then transferred to magnetic tape, then it is not necessary to retain the punched cards since the tape must be retained. If there is a duplication of data between punched cards and magnetic tapes, then the tapes shall always be retained rather than the cards.

Although EDP accounting systems will vary from one taxpayer to another, all systems must include a method of producing visible and legible records from the machine-sensible records which will provide the necessary information for the verification of the taxpayer's tax liability. Any records required under this subsection refer to printed "hard copy" records, and do not eliminate the necessity of maintaining the corresponding machine-sensible records as required by the previous subsection. These requirements apply to any taxpayer who maintains any records on EDP. The records to be maintained are as follows:

(1) A general ledger, with source references, to coincide with financial reports for sales tax reporting periods. In cases where subsidiary ledgers are used to support the general ledger accounts, the subsidiary ledgers should be written out periodically.

(2) The audit trail will be designed so that the details underlying the summary accounting data, such as invoices and vouchers, may be identified and made available to the Department upon request.

(3) The records must provide the opportunity to trace any transaction back to the original source or forward to a final total. If printouts are not made at the time of processing, then the system must have the ability to reconstruct these transactions.

(4) Adequate record-retention facilities must be available for storing all machine-sensible records as well as supporting documents.

(5) A general description of the EDP portion of the accounting system includes but is not limited to:

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(aa) Standard programming conventions and procedures including flowcharting conventions, decision table conventions, coding conventions, standard glossary and standard abbreviations, standard programming techniques, and debugging procedures and techniques.

(bb) Documentation of the system including a problem statement, systems flowcharts, operator instructions, record layouts, program flowcharts and sense switches, program listings, test data and approval and changes log.

(cc) Standard operating procedures and control procedures, including the reconciliation of EDP controls to non-EDP controls, error listings and error logs, and any other controls, either EDP or manual, used to insure accurate and reliable processing.

Any taxpayer retaining disbursement or revenue records on machine-sensible records for any individual original transactions, or any summary of such transactions subject to the tax under the provisions of the Sales and Use Tax Law shall separately show the amount of sales tax paid or the amount of sales tax collected. It shall be permissible, however, to group all taxable sales or all taxable purchases into various accounts, all of which are taxable, providing that if a nontaxable transaction is combined with a taxable transaction in the same account, then, with respect to each individual transaction, the tax shall be separately shown in the machine-sensible record.

Tax S&U 503 Commissioner may require security.

(a) In general. In order to assure payment of the tax due, the Commissioner may require that sufficient security be deposited with him by a retailer required to remit payment of the tax under the Sales and Use Tax Law.

The security so deposited may be in the form of corporate surety bond furnished by a surety licensed to do business in Minnesota, or United States Savings Bonds so registered that the proceeds will be made available to the Commissioner in the event that the necessity of recovering unpaid taxes arises; or such security may be in cash or in any other form agreed upon by the Commissioner and the person required to remit the tax.

The amount of security furnished shall not be more than twice the estimated liability for the period, or periods, in respect of which the returns are required to be filed, or $10,000.00, whichever amount is the lesser. The Commissioner, from time to time, may increase or decrease the amount of security but in no event shall such increase result in total security in excess of the limitation stated in this paragraph.

The Commissioner may offer for sale any property deposited as security, either at public auction or by any other appropriate method usually utilized in the sale of such property, provided such sale is necessary in order to recover any tax, penalty and interest required to be collected under the Sales and Use Tax Law.

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Notice of sale of such security must be served either personally upon the person who deposited the security or by mail in the same manner as used with respect to service of notice in Section 297A.31.

(b) Notice of retirement. Whenever the Commissioner requires a security deposit, he shall so notify, in writing, the person from whom the deposit is required. The written notification shall be signed either by the Commissioner or his authorized representative. The notice shall set forth the amount of security and the basis upon which the amount so required was computed. In addition, the notice shall inform the recipient as to the last effective date for depositing such security without incurring stated penalties.

Tax S&U 504 Extension of time to file return and remit tax. Whenever, in his judgment, good cause exists, the Commissioner may, upon application, extend the time for filing a return and paying the tax due thereon. Such extension shall not exceed sixty days from the date on which the return and the tax thereon are due. (See Section 297A.26, Subd. 1, and Section 297A.27, regarding due dates for filing returns and remitting tax.) If an extension of time is granted, and the remittance of tax is submitted prior to the expiration of the period for which the extension is granted, the tax will be deemed to have been paid timely.

Where an extension of time for payment has been granted, interest shall be payable at the rate provided in Section 297A.39 from the date when such payment should have been made if no extension had been granted, until such tax is paid.

Extension may be granted subject to the following conditions:

(1) the application must be filed on or before the due date for filing the return;

(2) separate applications must be made for each return (blanket requests for extensions will not be granted);

(3) each application must be filed in duplicate;

(4) the application must be signed by an applicant or his duly authorized agent; and

(5) the application must be forwarded to the Minnesota Department of Revenue, Sales and Use Tax Division, Centennial Office Building, Saint Paul, Minnesota 55145, and should be submitted in an envelope marked "Extension Request".

If the application is approved, the original copy, marked "Approved", will be returned to the applicant. The applicant, as approved, should be attached to the completed return when filed.

(Note: Form ST-9, Application for Extension of Time to File Minnesota Sales and Use Tax Return, is available upon request.)

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Tax S&U 505 Examination of return, adjustments, notices and demands.

(a) Proposed assessments. If, upon examination of the books of account and records of the person filing the return, facts are obtained which, in the opinion of the Commissioner, warrant an adjustment of the tax liability reported, a proposed assessment report will be prepared and mailed to him. This report will contain an explanation of adjustments together with a recomputation of tax in accordance with such adjustments.

The notice of adjustments and the demand for payment (if additional tax is due) or any other notice or demand upon the person filing the return required by law shall be sent to him at the address given in his return or to his last known address. In the alternative, the Commissioner may cause to be served upon such person a written statement of the computation of tax due.

In the event the person filing the return acquiesces in the changes reflected on the proposed assessment report, or fails to file a protest within the period specified in the letter accompanying the proposed report, the Commissioner will issue an order in accordance with the proposed assessment report, adding thereto statutory interest and penalty, if any. The Commissioner in his discretion may issue an order and omit the proposed assessment report where the adjustment is non-controversial or reflects mathematical or computational errors.

(b) If the Commissioner has reason to believe that the collection of any tax due under the Sales and Use Tax Law may be jeopardized, he may immediately terminate the reporting period of the person required to pay such tax. Thereupon the Commissioner may assess a tax on the basis of information or knowledge available to him and demand immediate payment. If such payment is not immediately made, the Commissioner may collect the tax by the use of any of the methods authorized by the Sales and Use Tax Law.

(c) Protests. Where a person does not acquiesce in the proposed assessment, he may file a protest within the period specified in the letter accompanying the proposed report. The proper form to be used in filing such protest follows. If, after a review of his protest, the Sales and Use Tax Division, hereinafter referred to as the Division, is unable to acquiesce therein, he will be afforded an opportunity to have a hearing before a representative of the Division upon request. If he is in agreement with the Division after such hearing, either the proposed assessment will be cancelled, or an order of the Commissioner will be issued in accordance with the terms of the agreement. If the person filing the return does not acquiesce in the position taken by the Division, he may request a hearing with respect to the same issues before the Commissioner. A letter addressed to the Commissioner and signed either by such person or by his attorney or agent is sufficient. The Commissioner subsequently will notify such person of the date set for the hearing. If he does not desire a hearing, an order will be issued within a reasonable time. If a hearing before the Commissioner is requested and granted, an order will not be issued until such time as the Commissioner has made a final determination.

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With the exceptions of the provisions of Section 271.06, Subd. 5, and Section 271.12, the issuance of an order by the Commissioner constitutes a final determination. The person filing the return is granted a period of thirty days from the date of mailing of such order within which to file an appeal with the Minnesota Tax Court.

The procedure outlined in this Regulation shall not preclude the Commissioner from imposing immediate assessments under the circumstances where the statute of limitations is about to run with respect to any return, or where the Commissioner has reasonable grounds for believing that the collection of any taxes, interest or penalties due under the Sales and Use Tax Law will be jeopardized.

Every order of the Commissioner shall take effect immediately upon the filing thereof and no appeal therefrom or review thereof shall stay the execution thereof or extend the time for the payment of any tax or other obligation unless otherwise expressly provided by law, except that no order for refundment by the Commissioner other than an order for the full amount of a claim for refund shall take effect until the time for appeal therefrom or review thereof by all parties entitled thereto has expired. For penalties and interest in the case of non-payment within the thirty-day period after issuance of such order, see Section 297A.39.

The protest, of which there must be two copies submitted to the Division, must be signed either by the person filing the return or by an individual authorized by him to do so, and should contain the following information:

(1) The name, address and the sales and use tax account number of the person filing the return;

(2) If such person is a corporation, the state wherein incorporated, as well as its principal office or place of business;

(3) The period for which the return was filed, and the amount of tax in dispute;

(4) An itemized schedule of the findings to which exception is taken;

(5) A summary statement of the grounds upon which such person relies in connection with each exception;

(6) In case a hearing is desired, a statement to that effect; and

(7) In case the protest is prepared or filed by an attorney or agent, a statement, signed by such attorney or agent, indicating that he prepared it and stating whether or not he knows that the facts therein are true.

Tax S&U 506 Failure to file a return.

(a) The following persons are required to file returns in accordance with the provisions of this Regulation:

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(1) A "retailer" as defined in Section 297A.01, Subd. 10;

(2) A purchaser making use of the subject of purchases obtained with an exemption certificate for other than the exempt purpose (see Section 297A.12);

(3) A person upon whom liability for use tax is imposed by Section 297A.14; and

(4) A "retailer" (either located within or without Minnesota) subject to Section 297A.16 and 297A.17.

(b) Any person described above who is required to file a return and fails to do so within the time prescribed by law or by regulation, or who files an incorrect, false or fraudulent return, shall, upon the written demand of the Commissioner, file the return required or the corrected return, as the case may be, within thirty days after the written demand for such return has been mailed to him, and at the same time pay any tax due on the basis of such return.

If the person upon whom the written demand has been made shall fail to comply therewith, the Commissioner, from his own knowledge and from such information as he can obtain through testimony or by any other means available to him, shall prepare a return or corrected return and assess a tax on the basis thereof. The tax so assessed shall be paid within ten days after the Commissioner has mailed to such person a written notice of the amount thereof and a demand for its payment.

(c) Pursuant to Section 297A.32, any return or corrected return or assessment made by the Commissioner shall be prima facie correct and valid, and the person for whom the return or corrected return was prepared and the tax thereunder assessed shall have the burden of establishing its incorrectness or invalidity in any action or proceeding in respect thereto.

Tax S&U 507 Time limitation on assessment and collection.

(a) In general. Except as otherwise provided in the Sales and Use Tax Law and except for such circumstances referred to in other regulations pertinent to Section 297A.34, the assessment of tax for any period for which a tax is due must be made within three years from the date the return was filed. A return filed before the last day prescribed by law for filing thereof shall be considered as filed on such last day.

An assessment of taxes shall be deemed to have been made whenever the Commissioner has prepared an order assessing such taxes and mailed such order to the post office address furnished on the return.

The Commissioner's record of the date of the order assessing the tax and the amount of tax assessed shall be presumptive evidence that the notice was duly given.

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(b) Omission of twenty-five percent. In the case of omission from the return of a dollar amount properly includible therein which is in excess of 25% of the dollar amount reported in the return the tax may be assessed or a proceeding in court for the collection of such tax may be begun at any time within five years after the return was filed.

The dollar amount reported in the return shall mean the total taxable amount as shown on the return which includes both taxable sales and purchases subject to the use tax.

For purposes of computing the dollar amount of the omission there shall not be included amounts disallowed as deductions or unreported retail sales which would constitute allowable deductions in determining net taxable sales.

Example 1. Taxpayer's return stated the following:

1. Gross Sales	$500,000.00
2. Deductions	450,000.00
3. Net Sales	50,000.00
4. Purchases Subject to Use Tax	None
5. Total Taxable amount	50,000.00

Upon audit it was discovered that there was omitted from the return a purchase of a machine for $20,000.00 upon which no tax had been paid. The percentage of the omission is:

$$\frac{\$20,000.00 \text{ (dollar amount of omission)}}{\$50,000.00 \text{ (dollar amount reported)}} = 40\%$$

Example 2. Taxpayer's return stated the following:

1. Gross Sales	$500,000.00
2. Deductions	440,000.00
3. Net Sales	60,000.00
4. Purchases Subject to Use Tax	10,000.00
5. Total Taxable Amount	70,000.00

Upon audit it was determined that deductions claimed in the amount of $440,000.00 included certain sales in the amount of $10,000.00 which were properly subject to the tax. The audit also disclosed purchases (properly taxable) in the amount of $15,000.00 upon which no tax was paid. The percentage of omission is:

$$\frac{\$15,000 \text{ (dollar amount of omission)}}{\$70,000 \text{ (dollar amount reported)}} = 21.4\%$$

(c) False and fraudulent returns. In the case of a false or fradulent return filed with intent to evade tax, or in the case where the person required to file a return fails to do so, the tax may be assessed at any time, or a proceeding in court for collection of such tax may be started at any time.

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(d) Waivers. The Commissioner of Revenue and the taxpayer may consent in writing to an extension of the period in which the tax may be assessed, provided a waiver is executed by both parties either within three years after the return was filed or, in the case of an omission of an amount as specified in clause (b) of this regulation, within five years after the return was filed. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(e) Collection of tax by court action. Where the assessment of tax is made within the period of limitation as prescribed above, the tax due and owing may be collected by a proceeding in court, provided that such action is instituted not later than nine months after the expiration of the period prescribed above for the assessment of the tax, or if there is an appeal from the Commissioner's order assessing the tax, not later than nine months after final disposition of such appeal.

Tax S&U 508 Claim for refund.

(A) In general. A person, as defined in Section 297A.01, Subd. 2, who has overpaid sales or use tax for any period, may file a claim for refund with the Commissioner for the amount of the overpayment. The claim for refund shall be submitted on Form ST-11 and shall be completed in the manner prescribed therein. Every adjustment to total taxable amount, credits and tax computation shall be adequately supported. The claim shall set forth in detail each ground upon which it is made, and facts sufficient to indicate to the Commissioner the exact basis thereof.

(B) Conditions to be met before the Commissioner shall entertain a claim for refund.

1. The person filing a claim for refund shall have paid the tax upon which the claim is based directly to the Commissioner (or the tax was collected from such person other than by means of court action in district court, either at law or in equity by the Commissioner), except the following:

a. A person who has paid an amount of tax to a retailer of electricity for agricultural production which is exempt from the tax under Section 297A.25, Subd. 1(h), may claim a refund or credit of such tax on his Minnesota Income Tax Return notwithstanding any other provisions of the Sales and Use Tax Law. Such refund or credit shall be made pursuant to Section 290.501.

b. A disabled veteran who himself purchases building materials or on whose behalf a contractor, subcontractor or builder purchases building materials after June 30, 1971, for use in the construction or remodeling of his residence, when the construction or remodeling is financed in whole or in part by the United States in accordance with 38 United States Code, Sections 801 to 805, as amended, may claim a refund directly from the Commissioner. Claim for Refund Form ST-11dv is available upon request from the Department of Revenue for use by disabled veterans in making such claims. See Tax S&U 419.

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Example 1. "X" Company failed to file sales and use tax returns for the periods beginning August 1, 1967 and ending January 31, 1968. Acting upon information obtained from various sources, the Commissioner prepared returns for "X" Company for these periods and assessed a tax of $900.00, plus penalties and interest. As "X" Company did not pay the tax, penalties or interest within thirty days, the Commissioner brought an action in Ramsey County District Court to collect the tax. Although "X" Company contested the action, the Court rendered judgment in favor of the Commissioner for the entire amount of the assessment plus penalties and interest. Thereafter, "X" Company paid the amount due and filed a claim for refund for $300.00. "X" Company submitted additional information tending to substantiate its claim. However, as the payment was collected by means of a court action (see Section 297A.33, Subds. 1 and 3), the Commissioner must deny the refund.

Example 2. "Z" Company billed Consumer for the purchases made by latter. Consumer, who was engaged in industrial production, paid the amount billed, plus sales tax thereon, although the materials used by him were exempt from the tax because they were consumed in industrial production. Thereafter, Consumer filed a claim for refund of tax on materials properly exempt. The claim for refund will be denied as Consumer did not pay the tax to the Commissioner. However, "Z" Company may file with the Commissioner for refund of such overpayment.

Example 3. Electrical Power Cooperative billed Farmer for the total amount recorded on the latter's meter. Farmer, who was engaged in agricultural production, paid the amount billed, plus sales tax thereon, although fifty percent of the electricity used by him was exempt from tax because it was consumed in agricultural production. Electrical Power Cooperative may complete the affidavit portion of Form EAC and furnish it to Farmer to be completed and filed by Farmer with his Minnesota Income Tax Return in accordance with Section 290.501.

2. A claim for refund shall be filed within two years after a tax was paid or collected, or within three years after a return was filed, whichever period is longer. If the Commissioner and the claimant have consented to extend the time for assessment of tax under the provisions of Section 297A.34, Subd. 6, the claim may be filed within such extended period. For purposes of ascertaining whether a claim for refund is timely filed with the Commissioner, a return filed prior to the date on which such return was due shall be determined to have been filed on the date when due. A return postmarked on the date due shall be determined to have been filed as of that date.

Example 1. "R" filed a sales and use tax return on January 15, 1968 for the month of December, 1967, and paid to the Commissioner $1,200.00, the tax due on the return. On January 20, 1971, "R" filed a claim for refund of $300.00 and submitted evidence tending to substantiate his claim. The Commissioner will act on the claim for refund as it was filed within three years of the period beginning on January 25, 1968, the due date for filing the return for December, 1967.

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3. Such person shall have filed the sales and use tax return upon which such claim is based. A claim filed by a corporation must bear the signatures and titles of the officers having the authority to sign for the corporation.

Whenever it is necessary to have the claim executed by an attorney or agent on behalf of the claimant, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the claimant must accompany the claim.

If a return is filed by a person who dies after filing such return, and a refund claim is thereafter filed by a legal representative of the decedent, certified copies of the letters testamentary, letters of administration or other similar evidence must be annexed to the claim to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver or other fiduciary files a return and thereafter a refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing the return was filed by the fiduciary and that the latter is still acting in such capacity.

C. Action taken by the Commissioner after a claim for refund is filed.

1. Upon receipt of a claim for refund, the Commissioner shall examine the return and make any investigation or examination of any of the accounts and records pertaining to such claim that he deems necessary. The Commissioner shall then prepare written findings, either denying or allowing the claim, in whole or in part, and shall mail a notice to the person filing the claim at the address stated on the return or to any other address furnished by the claimant in writing.

2. The amount allowed by the Commissioner as a refund shall first be applied against any sales or use tax owed to the Commissioner by the claimant, and any remaining balance due the claimant may be applied against any other delinquent tax liability owed by the claimant. Interest shall be allowed on the amounts refunded or credited from the date of overpayment to the date when such refund or credit is authorized by the Commissioner.

On overpayments made on returns due before July 2, 1975, interest shall be allowed at the rate of 4% per annum.

On overpayments made on returns due after July 1, 1975, interest shall be allowed at the rate of 6% per annum.

3. Where a claim for refund made by a vendor is based upon overpayment of sales tax by a consumer to the claimant, the Commissioner, for purposes of ascertaining the validity of such claim, may request substantiation of such overpayment by the consumer, or examine such consumer's records. If the Commissioner is unable to establish the validity of such overpayment after conducting an examination of the consumer's records, he shall deny the claim.

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D. Amended sales and use tax return may be filed in lieu of claim for refund Form ST-11. An amended sales and use tax return or consumer's use tax return may be filed in lieu of Form ST-11. However, it is necessary that every adjustment to the total taxable amount on the amended return be adequately supported. The amended return shall be filed for the same period as the period that is being corrected and the words "Amended Return" shall be placed at the top of the return. The same requirements indicated in this regulation for filing a claim for refund, Form ST-11, apply to amended returns filed in lieu of Form ST-11.

E. No refund shall be made where the amount is $1.00 or less.

Tax S&U 509 Appeal from denial of claim for refund. If a claim is denied in whole or in part, the taxpayer may take an appeal from the Commissioner's order denying the claim, directly to the Minnesota Tax Court pursuant to the provisions of Section 271.06. Such an appeal shall be made normally within thirty days from the filing of the Commissioner's order denying the claim, and, in any event, if such period is extended by the Minnesota Tax Court, within sixty days from the date of filing of the Commissioner's order.

The claimant may, in the alternative, bring an action in the district court of the district wherein lies the county in which the claimant resides or has his principal place of business. If the claimant is an estate or trust, it may, if it so elects, commence its action in Ramsey County District Court.

The statutory period within which an action in district court may be commenced is six months after the claim is filed if the Commissioner has not taken final action thereon, and shall be commenced within eighteen months after the notice of the order denying the claim. The claim is not considered denied by reason of non-action on the part of the Commissioner. The eighteen month period does not begin to run in such case until notice of the Commissioner's order denying the claim is mailed to the claimant.

Tax S&U 510 Penalties and interest.

A. Interest. Interest on unpaid liabilities shall accrue as follows:

1. On returns due prior to May 24, 1969 unpaid tax plus the late payment penalty shall bear interest at the rate of four percent per annum until May 24, 1969 and thereafter at the rate of eight percent per annum on the total of the tax plus all penalties.

2. On returns due after May 23, 1969 and prior to July 2, 1975 unpaid tax plus all penalties shall bear interest at the rate of 8% per annum.

3. On returns due after July 1, 1975 unpaid tax plus all penalties shall bear interest at the rate of 10% per annum.

B. Late payment. In accordance with Minn. Stat. § 297A.39, if a taxpayer fails to pay any tax imposed by the Sales and Use Tax Law or any portion of

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such tax when due, a penalty equal to ten percent of the tax unpaid shall be assessed unless the Commissioner has extended the time for filing the return and remitting the tax. (See Minn. Stat. § 297A.26, .27 and .30 regarding the due date for filing the return and remitting the tax.)

The amount of tax not timely paid together with the penalty imposed thereon shall bear the applicable rate of interest from the time the tax should have been paid until paid. The phrase "timely paid" means the due date as provided by law or under an extension of time as granted by the commissioner.

Example 1. On November 24, 1971, Retailer remits tax of $200.00 due on October 25, 1971, for the month of September. A ten percent penalty is assessed. The required amount to be paid on November 24, 1971, is calculated as follows:

Tax due and owing	$200.00
Ten percent penalty	20.00
Tax and penalty	$220.00
Interest for 30 days at 8%	1.45
Total amount due	$221.45

Example 2. "Retailer" requests an extension of thirty days in which to file the return and remit the tax thereon for the month of August, 1971. The Commissioner grants an extension of thirty days until October 25, 1971. The tax due is $500.00. On November 24, 1971, Retailer remits the tax, penalty and interest computed as follows:

Tax due and owing		$500.00
Ten percent penalty		50.00
Tax and penalty		$550.00
Interest on tax due of $500.00 from original due date to extended due date at 8%	$3.29	
Interest on tax and penalty from extended due date to date filed at 8%	$3.62	
		6.91
Total amount due		$556.91

Example 3. On November 24, 1975, Retailer remits tax of $200.00 due on October 25, 1975, for the month of September. A ten percent penalty is assessed. Since the return was due after July 1, 1975, the tax and penalty bear interest at the rate of 10%. The amount required to be paid is calculated as follows:

Tax due and owing	$200.00
Ten percent penalty	20.00
Tax and penalty	$220.00
Interest for 30 days at 10%	1.80
Total amount due	$221.80

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C. Wilful neglect. A penalty is provided for failure to file a return and pay the tax due thereon at the due date or at the expiration of the period for which an extension has been granted by the Commissioner. Unless the person required to file the return shows at the time of filing that his failure to do so is not by reason of wilful neglect, pursuant to Minn. Stat. § 297A.39, subd. 2, the Commissioner shall add to the tax in lieu of the ten percent specific penalty provided in B. above, a ten percent penalty from the first thirty days immediately following the failure to file the return or remit the tax timely, and an additional five percent for each additional thirty days or fraction thereof during which failure continues. The total penalty assessed under this clause shall not exceed 25 percent in the aggregate. However, if the penalty as computed for the period does not exceed $10.00, a minimum penalty of $10 shall be assessed. The amount so added shall be collected at the same time and in the same manner as the tax due.

The wilful neglect penalty will be assessed unless the person required to file the return exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time. The burden of proving that the imposition of this penalty is erroneous rests on the person required to file such return.

The progressive penalty imposed by this clause is in lieu of the ten percent penalty imposed under clause B. above. Consequently, as in the case in respect of the ten percent penalty imposed under clause B., the tax plus penalty bears interest for the period dueing which failure to file continues. The following example is illustrative: The return for August, 1971, reflecting the tax of $300.00 is filed on December 24, 1971.

Tax due and owing	$300.00
Twenty percent penalty	60.00
Tax and penalty	$360.00
Interest for 90 days at 8%	7.10
Total amount due	$367.10

D. Failure to file with intent to evade tax—fraud. Where a person is required to file a return under the Sales and Use Tax Law, and with intent to evade the tax fails to do so, or files a fraudulent return, an amount equal to 50 percent of the amount found to be due shall be added thereto. This penalty shall be in addition to any other penalties and interest provided by Minn. Stat. § 297A.39, whether such penalties be civil or criminal.

E. Criminal punishment; persons to be charged. In addition to the penalties prescribed above, Minn. Stat. § 297A.39, subd. 4, provides criminal penalties for wilfully failing to file a return or for wilfully filing a false return, or for wilfully refusing to pay over to the Commissioner the tax collected under the Sales and Use Tax Law on behalf of the State of Minnesota.

Where the tax due exceeds $100.00 for the period involved, the person shall be guilty of a felony; for amounts not exceeding $100.00 for the period involved, the person shall be guilty of a gross misdemeanor.

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For purposes of imposing criminal liability under this clause D., the term "person" includes any officer or employee of a corporation or a member or employee of a partnership where such officer, member or employee of a partnership or corporation, as the case may be, is under a duty to perform the act in respect to which the violation occurs.

F. Abatement of penalties and interest. Pursuant to Minn. Stat. § 297A.39, subd. 6, and Minn. Stat. § 270.07, subd. 1, the Commissioner shall have the power to abate penalties and interest when, in his opinion, their enforcement would be unjust and inequitable. The exercise of this power shall be subject to the approval of the Attorney General if the abatement exceeds $500.00. All requests for abatement of penalties and/or interest shall be in writing and shall set forth the reasons for the failure to file the return and pay the tax timely.

Tax S&U 511 Limitations on disclosure of sales and use tax information. The particulars disclosed in any report or sales and use tax return as well as any information acquired from the records or from officers or employees concerning affairs of the person filing the return may not be divulged or made known other than to persons qualified or authorized under the Sales and Use Tax Law. Any person violating this provision shall be guilty of a gross misdemeanor. .

The secrecy provision of Minn. Stat. § 297A.43 does not prohibit the Commissioner from publishing statistics regarding sales and use tax returns in cases where the statistics do not identify in any manner the persons who filed the returns.

The secrecy provisions will not be violated where the Commissioner or one of his employees, with respect to any inquiry regarding the issuance of a permit to a named retailer, advises the person making the inquiry whether or not a permit has been issued to such retailer. The inquiry may be furnished such particulars in respect of information contained on the permit, such as sales and use tax account number, and date of issuance of the permit, and whether the permit is still active.

The Commissioner is authorized on a reciprocal basis to exchange information with the taxing officials of another state or with the taxing officials of any municipality of this state which has a local sales or use tax.

To insure consistent application and enforcement of all tax laws administered by him, the Commissioner is also authorized by Section 270.065 to use information on sales and use tax returns to administer laws relating to toher taxes under his jurisdiction. He may also use any information in his possession relating to other taxes to administer the Sales and Use Tax Law.

The Commissioner may, at his discretion, furnish the Motor Vehicle Division, Department of Public Safety, all information necessary to administer the Motor Vehicle Excise Tax, Minn. Stat. Ch. 297B.

Tax S&U 512-599 Reserved for future use.

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CHAPTER SIX: Tax S&U 600-699
SPECIFIC BUSINESSES AND ACTIVITIES

Tax S&U 600 Veterinarians. The veterinarian is primarily engaged in the business of rendering professional services to the owners of domestic animals, through care, medication and treatment of such animals. He is the user and consumer of all such items of tangible personal property as drugs, medicines, bandages and dressings, serums, tonics and vitamins used by him in connection with the performance of his services unless he bills the customer separately for the services rendered and the materials used in the course of rendering such services. The veterinarian may accept unit or blanket exemption certificates from persons engaged in agricultural production for such sales that are billed separately or for other retail sales of the above items where services are not rendered in connection with the sales.

Retail sales by the veterinarian of items that are not used or consumed in agricultural production are taxable. For example, worm pills sold for treatment of the family pet dog would be taxable.

If the veterinarian both sells and administers a drug or medicine to an animal, merely charges for his services and absorbs the cost of drugs and other materials in his service charge, no tax should be charged by the veterinarian. The veterinarian is the consumer of such drugs and materials and the sale of the drugs or material by the supplier to the veterinarian is a taxable retail sale.

If the sales tax was not paid on purchases of such items at time of purchase from suppliers because purchased for resale, the veterinarian must report the use tax due thereon in the sales and use tax return covering the period in which professional use was made of the item by the veterinarian.

Tax S&U 601 Commercial artists and photographers. Commercial artists and photographers engaged in the creation or production of art work for sale to advertisers, printers and others for reproduction, display or use in the preparation or production of advertising or industrial materials, designs, etc., are regarded as retailers for sales and use tax purposes. Consequently, sales by them of drawings, sketches, paintings, illustrations, photographs, motion picture films, audio and video tapes, negatives, transparencies, mats, plates, engravings, designs, lettering, signs, show cards, posters, assemblies (key lining and paste-ups) and all other forms of tangible personal property are subject to the sales and use tax, whether or not the materials utilized are furnished by the customer. The tax applies to the total price charged, including amounts attributable to personal services of models, assistants, etc., and to preliminary art which becomes physically incorporated into finished art as for example, when the finished art is made by inking directly over a pencil sketch or drawing. Separately stated charges for preliminary art, in the form of roughs, visualizations, comprehensives and layouts, where the preliminary art does not become physically incorporated into finished art shall be considered charges for services and not subject to tax.

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Retouching constitutes a step in the process of preparing photographs or other art work for reproduction and is done to improve the quality of the reproductions. Tax applies to charges for photo retouching unless it can be clearly demonstrated that the retouching is done only for the purpose of repairing or restoring a photograph to its original condition.

Since commercial artists and photographers are engaged in the production of tangible personal property intended to be sold ultimately at retail, purchases by them of items which are used or consumed in such production, whether or not the items so used become ingredients or constituent parts of the property produced, are exempt from the tax in accordance with the provisions of Minn. Stat. § 297A.25, subd. 1(h). Machinery, equipment, implements, tools, accessories, appliances, contrivances, furniture and fixtures used in such production and fuel, electricity, gas or steam used for space heating or lighting, are not included within this exemption.

Commercial artists and photographers are users or consumers of, and must pay tax on, materials utilized in the preparation or production of preliminary or creative art work used to display ideas to prospective customers where no contract is made for sales of finished art to the customer.

An exemption certificate submitted by a purchaser and accepted in good faith by a commercial artist and/or photographer pursuant to Tax S&U 207 shall be sufficient to relieve responsibility to collect the tax.

Tax S&U 602 Florists and nurserymen.

(a) Taxable. Sales at retail by florists, nurserymen or other producers or vendors of trees, flowers, wreaths, bouquets, potted plants, shrubbery, hospital baskets, funeral designs, grass, seeds, nursery seedling stock (to be used for landscaping, windbreaks, shelterbelts, erosion control, soil conservation, wildlife cover, commercial production of fruit and cut flowers and other such purposes) and all other flowers, plants or merchandise, whether grown by such vendors or not, are sales of tangible personal property to which the tax applies.

Sales by florists, nurserymen or other persons of shrubbery, plants, sod, trees and similar items which such vendors are required to transplant on the land of the purchaser for a lump sum or flat rate are subject to tax. The total sales price of such property and services shall be the basis of the tax unless the vendor separately states the charge for the services in transplanting, in which event the basis of the tax shall be the charge for the tangible property only.

Purchases by such vendors of machinery, equipment, implements, tools, accessories, appliances, contrivances, furniture and fixtures, and fuel, electricity, gas or steam used for space heating or lighting are taxable unless purchased for resale.

(b) Exempt. Sales of trees, plants, seeds or similar items to persons for use

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in agricultural production of tangible personal property for resale are exempt (upon presentation of proper exemption certificates to the vendors) if such purchasers are commercial growers of the particular items purchased. For example, stock purchased for the purpose of reforestation where forest products will be later harvested in the form of Christmas trees, posts, poles, pulpwood, etc., are exempt.

Purchases by florists, nurserymen or other like producers or vendors of plants and other merchandise, including non-returnable containers and labels, stickers and cards affixed to such containers, peat moss, sand, gravel, crushed rock, shavings, sticks, trellises and plant ties to be placed in pots or cans with plants and ultimately sold along with the plants, are exempt as purchases for resale. Purchases of nursery stock, seeds, plants, spray materials and fertilizers to grow nursery stock for resale are exempt as items to be used or consumed in agricultural production and ultimately sold at retail. Electricity and fuel are also exempt, except that the portion used for space heating or lighting is taxable.

(c) Telegraphic orders. Where florists or nurserymen conduct transactions through a florist telegraphic delivery association, or otherwise by telephone, telegraph, or other means of communication with other florists or nurserymen, the following rules will apply in the computation of the tax:

(1) Sending florist: Where an order for flowers, wreaths or other merchandise is taken from a customer by a Minnesota florist or nurseryman and transmitted to another florist or nurseryman located within or outside of Minnesota for delivery, the florist or nurseryman who initially takes the order from the customer is required to collect the tax.

(2) Receiving florist: Minnesota florists or nurserymen who receive orders from other florists or nurserymen, whether located within or outside this state, for delivery of flowers, wreaths or other merchandise to locations either within or outside of Minnesota, do not collect the tax.

(3) Other charges: The sales tax does not apply to telegraph, telephone or "service" charges if such charges are separately stated from the price of the flowers or other merchandise ordered by the customer.

(d) Sales to non-residents. Sales of flowers or other merchandise which the florist or nurseryman delivers to points outside Minnesota by messenger or common carrier are not subject to the tax if the order is received from a non-resident customer to whom such flowers or other merchandise are sent. If the flowers or other merchandise are to be delivered to a third person (i.e. someone other than the customer who makes the purchase), title passes to the purchaser in this state at time of sale and the tax applies even though delivery is to a point outstate.

Tax S&U 603 Soft water equipment and service dealers.

(a) Sales. Receipts from sales of water softening equipment and tanks

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which are permanently affixed by the dealer to real property leased or owned by the purchaser are considered sales of equipment for the improvement of real property and are exempt from the Minnesota Sales Tax. Sales to dealers of such water softening equipment and tanks are considered retail sales and are subject to the tax at the time of sale to the dealer, who is considered the user thereof. Sales of equipment, tanks, replacement parts, salts and other chemicals directly to customers are taxable at the retail price if not installed by the dealer.

(b) Rentals. Receipts from rentals of automatic and semi-automatic water softener equipment and tanks, regardless of how attached to the premises of the lessee, are subject to the Sales and Use Tax. The rental, lease, or lease coupled with an option to purchases of such equipment and tanks constitutes "a sale at retail" of tangible personal property, and all persons regularly engaged in such business are retailers. The tax does not apply to the installation charges if separately stated on the initial invoice or billing. Sales to dealers of automatic and semi-automatic equipment and tanks intended to be used only for leasing to customers are considered "sales for resale."

(c) Service. The installation of exchange water softening equipment in the premises of customers, and the subsequent, regular replacements of chemically-treated tanks by water softener dealers constitute a personal service. The installation and regular replacement charges therefor are not subject to the tax. The sales of minerals, salts and other chemicals, and equipment, tanks, parts, and materials to water softener dealers to be used in conjunction with such service are subject to the Sales and Use Tax.

Tax S&U 604 Sales and rentals of mobile homes and house trailers.

A. Sales or rentals of property not permanently affixed to realty. The sale, rental or use of a mobile home or house trailer which is not permanently affixed to realty, including all equipment placed thereon by the dealer or manufacturer and included in the selling price, is a sale, rental or use of tangible personal property. Dealers selling such property should collect sales or use taxes. If such property is subsequently registered as a recreational vehicle by the purchaser, credit against the motor vehicle excise tax imposed by Minn. Stat. ch. 297B will be allowed for sales taxes paid to the dealer.

Lessors of such property should collect sales or use taxes on the rental payments.

B. Property permanently affixed to realty. In some cases, mobile homes or house trailers may lose their identity as personal property because of alterations made to them. Such property will be considered to be real property if all of the following criteria are met:

1. The unit must be affixed to the land by a permanent foundation or in a manner similar to other real property in the district.

2. The unit must be connected to public utilities, especially water and

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sewer or have its own well and septic tank system or be commensurate with other real property in the district insofar as these facilities are concerned.

3. The wheels must be removed.

Sales of property meeting this criteria are exempt sales of real property.

C. Exempt lodging. Where mobile homes and house trailers are permanently affixed to realty in accordance with clause B. amounts received by the lessor for the rental or use solely for the purpose of lodgings by the lessee for a continuous period of thirty days or more are exempt.

Tax S&U 605 Advertising agencies.

(a) In general. An advertising agency may operate as an independent service business or as an agent of the advertiser. Therefore, a principal-agent relationship shall not be presumed. See Section C relative to requirements relating to principal-agent relationships.

(b) Agency as independent service business.

(1) Nontaxable services. Tax does not apply to charges for services rendered that do not represent services that are a part of a sale of tangible personal property, or a labor or service cost in the production of tangible personal property. Examples of such nontaxable services are: writing original manuscripts and news releases; writing copy for use in newspapers, magazines, or other advertising, or to be broadcast on television or radio; compiling statistical and other information; placing and/or arranging for the placing of advertising in media, such as newspapers, magazines, or other publications, billboards and other forms of outdoor advertising, cards in cars, buses and other facilities used in public transportation; and delivering or causing the delivery of brochures, pamphlets, cards, etc. Charges for such items as supervision, consultation, research, postage, express, telephone and telegraph messages, transportation and travel expense, if involved in the rendering of such services, are likewise not taxable.

When an amount billed as an agency "fee", "service charge", or "commission" represents a charge or part of the charge for any of the nontaxable services described in the above paragraph, the amount so billed is not taxable. Such a charge by a recognized advertising agency will be considered to be made for nontaxable services.

(2) Preliminary art. "Preliminary art" as used herein means roughs, visualizations, comprehensives and layouts prepared for acceptance by clients before a contract is entered into or approval is given for finished art. ("Finished art" as used herein means the final art used for actual reproduction by photo-mechanical or other processes.) Tax does not apply to separate charges for preliminary art except where the preliminary art becomes physically incorporated into the finished art, as for example, when the finished art is made by inking directly over a pencil sketch or drawing, or the approved layout is used as camera copy for reproduction.

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The charge for preliminary art must be billed separately to the client, either on a separate billing or separately charged for on the billing for the finished art. It must be clearly identified on the billing as preliminary art, of one or more of the types mentioned in the preceding paragraph. Proof of ordering or producing the preliminary art prior to date of contract or approval for finished art shall be evidenced by purchase orders of the buyer, or by work orders or other records of the seller. No other proof shall be required.

(3) Retail sales. Where an advertising agency acts as a commercial photographer or other similar independent business and agrees to provide certain material to a client (e.g. sell a quantity of advertising brochures to such client) at a flat fee, the advertising agency is acting as a retailer and is required to collect the tax from the purchaser and remit the same to the Commissioner of Revenue. The tax also applies to the entire amount charged to clients for items such as drawings, paintings, designs, photographs, lettering assemblies and printed matter.

(4) Items purchased by agency. An advertising agency is the consumer of tangible personal property used in the operation of its business, such as stationery, ink, paint, tools, drawing tables, T-squares, pens, pencils and other office supplies. Tax applies to the sales of such property to the agency.

The agency is the seller of, and may purchase for resale, any item that it resells before use, or that becomes physically an ingredient or component part of tangible personal property sold by it; as, for example, illustration board, paint, ink, rubber cement, flap paper, wrapping paper, photographs, photostats, or art purchased from other artists.

(c) Principal-agent relationship. In order that vendors, advertising agencies and advertisers may be more certain of their obligations and liabilities or potential liabilities for sales and use taxes in respect of transactions in which advertising agencies are a party and for purposes of orderly, efficient and equitable administration of the Minnesota Sales and Use Tax Law a principal-agent relationship shall not be recognized unless there is a written agreement expressing and establishing such relationship and clearly setting forth the scope of the agent's authority.

In dealing with advertising agencies, vendors shall presume that the agency is the purchaser in the absence of an express statement on a purchase order from an advertising agency that the advertising agency is acting as a true agent pursuant to a written agreement and that the purchase is within the scope of authority expressed in such agreement. Advertising agencies acting as true agents making purchases on behalf of specific clients are required to pay sales and use tax on all purchases of tangible personal property to the exact degree that the respective client would be liable if purchasing such materials directly from primary suppliers; and, therefore, the agency may issue exemption certificates as authorized in Tax S&U 207 in the name of the principal and signed by the advertising agency as true agent.

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Tax S&U 606 Sales by governmental units; taxable. Although sales of tangible personal property to the United States and its agencies and instrumentalities or to a state and its agencies, instrumentalities and political subdivisions are exempt from tax, this exemption does not extend to tangible personal property purchased from the United States, the State of Minnesota and other governmental units.

Example. The Minnesota state prison makes retail sales of office furniture and other items manufactured there. Such sales are taxable unless exempt under other provisions of the Sales and Use Tax Law.

If law or ordinance requires a governmental agency to furnish copies of documents held in its files, the furnishing of such copies is a governmental act or service and shall not constitute a taxable retail sale.

Concessionaires operating on government property are retailers making sales in the ordinary course of business. Such concessionaires are required to collect the tax and remit the appropriate amount of tax to the Commissioner.

Various levels of government may, in the usual course of business, dispose of used, obsolete or surplus equipment by means of periodic sales to the public or to its employees. Such sales are not isolated or occasional sales of tangible personal property if regularly made, and are taxable sales unless exempt under other sections of the Sales and Use Tax Law.

Tax S&U 607 Advertising signs and billboards.

Sign painters: The sales and use tax applies to retail sales of metal, wood, cardboard, paper or other type signs, showcards, posters, etc. which are not attached or affixed to real estate by the sellers thereof. Purchases by sign manufacturers or painters of paint and other materials entering into or becoming component parts of such signs, showcards and posters are exempt. Charges by sign painters for painting signs on buildings, outdoor boards, windows, or other real property, trucks and similar properties owned by others are exempt as charges for personal services. The sign painter is considered the user or consumer of all paint, etc. used for this purpose and must pay sales or use tax, whichever is applicable, upon all purchases thereof.

Sales of realty: Contracts under which the sellers provide signs and attach them to buildings or to structures bolted to buildings or to structures anchored in the ground by means of wood or steel poles or other similar means, so that the signs become non-temporary accessions to such buildings or structures, are deemed to be contracts for the alteration of real property and are thus not transactions subject to the sales tax. Persons who provide and install such signs are the consumers of, and must therefore pay tax on, all purchases of, all component parts, materials and supplies used in the construction, repair and maintenance thereof.

Sign rentals: The lease charges for rental of real property are not subject to

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tax. Charges for the lease of signs attached to real property are not taxable. The signs, when attached to buildings, are fixtures becoming real property upon being affixed.

Charges by tenants or owners of buildings, structures, or land for affixation thereon of signs are exempt as charges for the lease or license to use real property.

Outdoor advertising services: Persons engaged in the business of selling advertising space ("exposure time") on signs, billboards and other outdoor advertising structures are deemed to be the consumers of all component parts, materials and supplies used in the construction, repair and maintenance of such signs and billboards. Sales to such persons of component parts, materials, and supplies are subject to tax. Charges by such persons for advertising space on such signs, billboards and outdoor advertising structures are exempt as charges for personal services.

Tax S&U 608 Aircraft registration.

A. In general. Minn. Stat. § 297A.255 requires persons who wish to license or register an aircraft in Minnesota to furnish proof to the Department of Transportation, Aeronautics Division that the Minnesota Sales or Use Tax has been paid, or that the purchase of the aircraft was not subject to the Minnesota Sales or Use Tax. The effect of this law is to impose a use tax on occasional or isolated sales of aircraft in those cases involving sales to individuals not in the business of selling aircraft. The law is effective for registrations applied for after June 30, 1973.

The necessary forms (Form UT-1 and Form ST-24) for reporting and paying the use tax or for claiming exemption are available upon request from the Minnesota Department of Revenue and the Minnesota Department of Transportation, Aeronautics Division.

This statute does not affect the exemption provided for purchases of air flight equipment by airlines taxed under Minn. Stat. § 270.071 through 270.079.

When the sales tax has not been paid to the dealer as set forth in B.1. below, the Department of Revenue will forward a completed certificate of tax payment or exemption, Form ST-24, to the Department of Transportation, Aeronautics Division.

B. Registration of aircraft by individuals.

1. Minnesota sales tax paid to dealer. When a purchaser pays the Minnesota sales tax to a Minnesota aircraft dealer who holds a Minnesota Sales and Use Tax Permit, the dealer shall furnish the purchaser with a statement showing that the sales tax has been paid. The aircraft dealer will report and pay the sales tax to the Minnesota Department of Revenue as in the past. It is not necessary for the purchaser of the aircraft to obtain a Certificate of Tax

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Payment or exemption, Form ST-24, from the Minnesota Department of Revenue. The purchaser should present the statement, which he received from the aircraft dealer, directly to the Department of Transportation, Aeronautics Division in order to license or register the aircraft.

2. No Minnesota sales tax paid to seller. When the purchaser does not pay a Minnesota sales tax to the seller on his purchase of an aircraft, he must obtain a Certificate of Tax Payment or Exemption, Form ST-24, from the Minnesota Department of Revenue. If a use tax is due, the purchaser must complete a Consumer's Use Tax Return, Form UT-1, and file it along with his tax payment when applying for the Certificate Form ST-24. If the purchaser claims exemption from the tax, he must furnish a copy of his purchase invoices or bill of sale along with necessary proof showing that he is entitled to the exemption when applying for the certificate. Exemptions are allowed for purchases by governmental units and by organizations that are organized and operated exclusively for charitable, religious or educational purposes; for aircraft purchased outside Minnesota by a non-resident and later brought into Minnesota for use; and for aircraft purchased for resale or lease.

C. Registration of aircraft by dealers who are licensed in accordance with Minn. Stat. § 360.63. When a licensed dealer purchases an aircraft for resale and places it in a withholding status, no Certificate of Tax Payment or Exemption is required. When a licensed dealer registers an aircraft for commercial use, he must present a Certificate of Tax Payment or Exemption to the Minnesota Department of Transportation, Aeronautics Division. He will be required to pay a use tax on his purchase price of the aircraft unless he makes application to the Commissioner of Revenue for an Aircraft Commercial Use Permit, Form ST-23, and pays a $20 fee. By obtaining an Aircraft Commercial Use Permit, Form ST-23, a licensed dealer may purchase an aircraft for resale and put it to commercial use such as crop dusting, charter service, freight transportation and flight instruction, for up to one year without paying a sales or use tax on his purchase. When he sells the aircraft, he is required to collect a sales tax. If he keeps the aircraft for more than one year or makes personal use of such aircraft, a use tax is also due on his purchase price. A licensed aircraft dealer who obtains a Commercial Use Permit, Form ST-23, should check the box of Section B of Form ST-24 which indicates that the aircraft was purchased for resale or lease by the holder of a Minnesota Sales and Use Tax Permit.

D. Registration by dealers who are not licensed in accordance with Minn. Stat. 360.63. This type of dealer is required to file Form ST-24, and should check the box of Section B which indicates the aircraft was purchased for resale or lease by the holder of a Minnesota Sales and Use Tax Permit. However, if the dealer purchases an aircraft for personal or commercial use, he is required to file Form ST-24 and Form UT-1 and pay the use tax on the purchase price.

E. Registration of aircraft by lessor or lessee. When a lessor registers an aircraft in his name, he may furnish his sales and use tax account number when applying for the Certificate of Tax Payment or Exemption, Form ST-24, and

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claim exemption for resale. He must continue to collect and remit sales tax on lease payments he receives, as in the past.

When a lessee registers an aircraft in his name, and the lessor does not hold a Minnesota Sales and Use Tax Permit, the lessee is required to obtain a permit. The lessee must pay the use tax on the amount of his lease payments in the same manner as all other Minnesota permit holders who are required to file sales and use tax returns.

F. A facsimile of the authorized aircraft certificate of tax payment or exemption (Form ST-24) is reproduced as follows:

Form ST-24

MINNESOTA DEPARTMENT OF REVENUE–
SALES AND USE TAX DIVISION

CERTIFICATE OF TAX PAYMENT OR EXEMPTION–AIRCRAFT

Pursuant to M.S. Section 297A.255

SECTION A–GENERAL INFORMATION			
Purchaser's Name			Federal Registration Number N-
Purchaser's Address (Street or RFD, City, State, Zip Code)			
Make	Year and Model	Trade Name	Date Purchased
Seller's Name and Address			

SECTION B–APPLICATION FOR CERTIFICATE
I, the undersigned purchaser, hereby make application to the Commissioner of Revenue for a Certificate of Tax Payment or Exemption as indicated below:
☐ A use tax of $_____ has been paid to the Commissioner of Revenue on my purchase of the aircraft described above.
☐ The purchase of the aircraft described above is exempt from Minnesota Sales and Use Tax for the following reason:
☐ Purchaser is a governmental unit.

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Form ST-24 (Cont.)

☐ Purchaser is an exempt religious or educational organization.

☐ Purchaser is a charitable organization holding a Certificate of Exempt Status, No. ES_____.

☐ Purchaser was not a resident of Minnesota when the aircraft was purchased.

☐ Aircraft was purchased for resale or lease by the holder of Minnesota Sales and Use Tax Account No._____.

I hereby declare, under the penalties of criminal liability for willfully making a false certificate, that this certificate has been examined by me and to the best of my knowledge and belief is true and correct and that I am duly authorized to sign this certificate.

Authorized Signature_____ Title_____ Date _____

SECTION C–CERTIFICATION TO BE COMPLETED BY DEPARTMENT OF REVENUE

Based on the information furnished by the above-named purchaser, I certify that:

☐ The use tax of $_____has been paid.

☐ The exemption claimed in section B is properly allowable, and no sales or use tax is due on the transaction.

Signature _____ Title_____ Date_____

THIS CERTIFICATE REMAINS SUBJECT TO AUDIT BY THE DEPARTMENT OF REVENUE

Mail to: Minnesota Department of Revenue
Sales and Use Tax Division
Centennial Office Building
St. Paul, Minnesota 55145

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Tax S&U 609 Iron mining industry exemptions.

A. General. The industrial production exemption provided in Minn. Stat. 297A.25, subd. 1(h), as amended effective January 1, 1974 is applicable to taconite mining and production operations and to the mining and producing of other ores as well. The exemption applies generally to electricity and all materials other than tools, machinery and equipment which are used in the production process, and to separate detachable units meeting the criteria specified in regulation Tax S&U 408.

In the case of mining, the production process shall be deemed to begin with the removal of overburden from the site of the ore deposit and to end when the last process prior to stockpiling is performed. If the product is not stockpiled prior to shipment, the production process shall be deemed to have ended when the last process prior to loading for shipment has been completed.

Clause B. sets forth examples of items which are illustrative of the exemption allowable for separate detachable units.

In addition to the general industrial production exemption, Minn. Stat. § 297A.25, subd. 1(o) provides a specific exemption for items used in the production of taconite. See clause (c).

To further clarify and illustrate the scope of the exemption specified in the preceding paragraphs, examples of items not considered to be exempt thereunder are set forth in clause (d).

B. The exemption for separate detachable units used in producing a direct effect upon the product provided in 297A.25, Subd. 1(h) became effective January 1, 1974. It is applicable to taconite mining and production operations and to the mining and producing of other ores as well. The following items are considered as having a direct effect upon the product and qualify for exemption where they are separate detachable units and their ordinary useful life is less than 12 months:

bucket lip on front-end loader used in other than stockpile loading
chunk breaker used to break up pellets fused into chunks
crushed bowls, concaves, mantles
dipper teeth but not dipper teeth adaptors
dozer blade cutting edges & end or corner bits plus blade bolts & nuts
drill bits and reamers used in drilling ore body for blasting
drop ball for breaking huge rock chunks
filter cloth or bags
grader blade cutting edges and end bits plus blade bolts and nuts
internal parts of an "Erie" type cyclone
magnetic separator covers on rough cobbers
ripper teeth for ground breaking
screen cloth or mesh or panels
splitter castings and grizzly castings used in crushers, loading and/or storage bins

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stationary and movable jaws on jaw crusher
wear shoes on spiral classifiers

C. The exemption provided in Minn. Stat. § 297A.25, subd. 1(o) is applicable only to companies involved in the mining and production of taconite. It exempts grinding rods, grinding balls, and mill liners used in the reduction and processing of the taconite ore.

For purposes of this exemption, the term "mill" includes all of the facilities used to reduce and process the ore. It does not include shovels or mobile equipment.

Any item which is an integral part of the plant equipment as opposed to being a liner serving to protect the equipment is not included within this exemption. Examples of items exempt as liners are:

autogenous mill liners, feed and discharge liners
chute liners (this may be a bar or a plate.)
classifier wear plates and classifier shoes
conveyor skirt board rubber liners
crusher bowl liners (concaves), mantle liners, feed and discharge liners
crusher spider caps, rims, liners, shell liners, lower hub liners, pinion shaft liners, feed opening liners, wear rings, torch rings, and other crusher related liners
cyclone classifier wear plates
cyclone collector wear plates
dump pocket wall liners, wear bars
linatex materials used in pipes, pumps, chutes, hoppers, etc.
mill liner bolts
nordbak kits (other than that used instead of zinc for bowls and mantles)

refractory brick in rotary kiln only
rod and ball mill liners, feed and discharge liners
rubber or like materials used as liners in pumps
steel wear plate or alloys used to line hoppers, bins, chutes, pockets or launders
urethane materials used to line filter sectors, separator covers, fan blades, vertical classifier internal surfaces, cyclone classifier and collector internal surfaces, pipe fittings, pipe liners, chutes, bins, launders and sumps
welding rods used to repair liners or wear plate

D. Examples of items of tangible personal property which do not come within the exemption provided under Minn. Stat. § 297A.25, subd. 1(h) or Subd. 1(o) are:

all motor and engines (electrical or otherwise)
burner tips
chute liners (other than in taconite operation)
conveyor belts

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conveyor belt wiper and idlers
drum separator lifter bar
filter arm
grate bars not used for sizing
grate side plates
kelly extension
materials and equipment including detachable tools used to maintain or repair plant or mining equipment
pan feeder plates
pump casing
pump impellers
pump side plate
replacement parts used to repair mine or plant equipment
truck filters
V belts and sheaves

Items found on mobile equipment such as:

adapters
cables
drill bars
drill cables
idlers and sprockets
rollers
shovel bucket liners
tires
track pads
truck box liners

Items found on traveling grate such as:

chain
grate casting
head casting
sprockets
tail casting

All refractories other than refractory brick in rotary kiln, including those used in horizontal and vertical furnaces, preheaters and annular coolers:

coupling liners
garbage can liners
mobile equipment liners
pillow block liners

Tax S&U 610 Automatic data processing.

A. In general. A sales or use tax is imposed upon the gross receipts from selling, leasing, or granting a license to use tangible personal property. The labor charges for repair, service and maintenance of tangible personal property is not subject to tax. The producing, fabricating, processing, printing or imprinting of tangible personal property for a consideration for consumers who directly or indirectly furnish the materials used in the producing, fabricating, processing, printing or imprinting is also subject to tax. The transfer of property produced, fabricated or printed to the special order of the customer is also subject to tax.

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This regulation sets forth guidelines for the application of the foregoing general statutory provisions to transfers of property and service rendered in the automatic data processing industry.

"Automatic data processing services" are those rendered in performing all or part of a series of data processing operations through an interacting assembly of procedures, processes, methods, personnel, and automatic data processing equipment. Automatic data processing services may be provided by manufacturers of data processing equipment, data processing centers, systems designers, consultants, software companies, etc. In addition, there are banks and other businesses which own or lease automatic data processing equipment and use it primarily for their own purposes but occasionally provide services to others. Businesses rendering automatic data processing services will be referred to herein as "service bureaus."

B. Description of terms.

Application: The specific job performance by an automatic data processing installation is called an "application". For example, data processing for a payroll may be called a payroll application.

Automatic data processing equipment: The term includes computers and their peripheral equipment as well as punched card tabulating machines.

Coding: The list, in computer code, of the successive computer instructions representing successive computer operations for solving a specific problem.

Input: The information or data transferred, or to be transferred, from external storage media (e.g. punched cards, punched paper tape and magnetic tape) into the internal storage of the computer.

Keypunching: Recording information in cards, paper tapes, or magnetic tapes, disc or drum by punching holes in the cards, paper tapes or inserting magnetic bits on magnetic tape, discs or drums, to represent letters, digits, and special characters. Keypunching includes the necessary preliminary encoding or marking of the source documents.

Keystroke verifying: Use of a machine known as a punched card verifier or tape transcriber, which has a keyboard, to ensure that information punched in a punch card or transcribed on magnetic tape during the keypunching operation has been punched properly. The machine signals when the punched hole on the card and the depressed key disagree, or when the data on magnetic tape differs from depressed keys.

Off-line: Descriptive of a system and the devices in a system in which the operation of equipment is not under the control of a computer.

On-line: Descriptive of a system and the devices in a system in which the operation of such system or devices are under control of a computer.

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Output: The information transferred from the internal storage of the computer to an external storage media (e.g., punched cards, magnetic tape, and tabulated listing).

Program: The complete plan for the solution of a problem, i.e., the complete sequence of automatic data processing equipment instructions necessary to solve a problem. It includes both systems and application programs and subdivisions such as assemblers, compilers, routines, generators, and utility programs.

Proof listing: A tabulated listing of input.

Source document: From which basic data are extracted (e.g., sales invoice).

C. Taxable transactions, unless otherwise exempt under Minn. Stat. ch. 297A.

1. Retail sales of new or used data processing equipment are taxable.

2. Leases of equipment are subject to tax. A lease includes a contract by which a lessee secures for a consideration the use of equipment which may or may not be on his premises if the lessee or his employees operate the equipment, or if the equipment is operated under the direction and control of the lessee or his employees. Subleasing receipts are taxable without any deduction or credit for tax paid by the original lessee to his lessor, if the original lessee uses the property in addition to subleasing it. Use of equipment on a time-sharing basis, where access to the equipment is only by means of remote access facilities, is not a taxable leasing of such equipment.

3. Keypunching and keystroke verifying. This item covers situations where a service bureau's agreement provides only for keypunching, keystroke verifying and proof listing of data or any combination of these operations. It does not include contracts under which these services are performed as steps in processing a client's data as discussed in D.1.

Agreements providing (a) solely for keypunching; (b) keypunching and keystroke verification; or (c) keypunching, providing a proof list and/or verifying of data, are regarded as contracts for the fabrication of punched cards and sales of proof lists. Charges therefor are taxable, whether the cards are furnished by the customer or by the service bureau. Data from source documents may also be recorded directly on magnetic tape (off-line). This operation may include keystroke verifying and/or proof listing of data and is comparable to the punch card operation. Charges for this operation are taxable whether the magnetic tapes are furnished by the customer or by the service bureau. Tax also applies to charges for the imprinting of characters on a document to be used as the input medium in an optical character recognition system. The tax application would be the same even though paper tape or other media were used in the operation.

4. Training materials. Persons who sell or lease data processing equip-

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ment may provide a number of training services with the sale or rental of their equipment. Training services, per se, are not subject to the tax. Training materials, such as books, furnished to the trainees for a specific charge are taxable.

5. Generally tax applies to the the conversion of customer-furnished data from one physical form of recordation to another. For example, if all or some data in punched cards is duplicated into another set of cards, charges for this service are taxable.

6. When additional copies of records, reports, or tabulations are provided, tax applies to the charges made for the additional copies. "Additional copies" are all copies in excess of those produced on multipart carbon paper simultaneous with the production of the original and on the same printer, whether the copies are prepared by rerunning the same program, by using multiple simultaneous printers, by looping a program such that the program is run continuously, by using different programs to produce the same output product, or by other means. Where additional copies are prepared, the tax will be measured by the charge made by the service bureau to the customer. Charges for copies produced by means of photocopying, multi-lithing, or by other means are also subject to tax.

7. Sales of mailing lists in the form of cheshire tapes, gummed labels and heat transfers produced as a result of a computer run are taxable. Computer generated mailing lists alone involving no transferable product are not taxable. However, where the service bureau, through the use of its automatic data processing equipment, addresses material to be mailed, with names and addresses furnished by the customer or maintained by the service bureau for the customer, tax does not apply to the charge for addressing. Similarly, where the service bureau prepares labels to be affixed to material to be mailed, with names and addresses furnished by the customer or maintained by the service bureau for the customer, tax does not apply to the charge for producing the labels, when the service bureau itself affixes the labels to the material to be mailed.

D. Non-taxable services.

1. Processing a client's data. "Processing a client's data" means the developing of original information from raw data furnished by the customer. Examples of automatic data processing operations which result in original information are summarizing, computing, extracting, sorting, and sequencing. Such operations also include the updating of a continuous file of information maintained by the customer with the service bureau.

Generally, if a person enters into a contract to process a client's data by the use of a computer program, or through an electrical accounting machine programmed by a wired plugboard, the contracts are non-taxable (except if the contract is in the nature of a lease as outlined in C.2. Such contracts usually provide that the person will receive the client's source documents, record data in machine readable form, (such as in punch cards or on magnetic

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tape), make necessary corrections, rearrange or create new information as the result of the processing and then provide tabulated listings or record output on other media. This service is considered non-taxable even if the total charge is broken down into specific charges for each step. The furnishing of computer programs and data by the client for processing under direction and control of the person providing the service is non-taxable even though charges may be based on computer time. The true object of these contracts is considered to be a service, even though some tangible personal property is incidentally transferred to the client.

"Processing a client's data" does not include: (1) work performed under an agreement providing solely for the reformatting of data or for the preparation of a proof listing or the performance of an edit routine or other preprocessing; (2) the using of a computer as a mere printing instrument, as in the preparation of personalized computer-printed letters; or (3) the mere converting of data from one medium to another.

2. Designing of systems, converting of systems, consulting, training, and miscellaneous services. These services consist of the developing of ideas, concepts and designs. Common examples of such services are:

Designing and implementing computer systems (e.g., determining equipment and personnel required and how they will be utilized).

Designing storage and data retrieval systems (e.g., determining what data communications and high-speed input-output terminals are required).

Converting manual systems to automatic data processing systems and converting present automatic data processing systems to new systems (e.g., changing a second generation system to a third generation system).

Consulting services (e.g., a study of all or part of a data processing system).

Feasibility studies (e.g., studies to determine what benefits would be derived if procedures were automated).

Evaluation of bids (e.g., studies to determine which manufacturer's proposal for computer equipment would be most beneficial).

3. Persons engaged in providing non-taxable computer services are the consumers of all tangible personal property used in such activities and the tax must be paid on their acquisition of such property.

E. Microfilming and/or photorecording services.

1. Some electronic data processing systems accept signals directly from the computer (on-line) at high speeds and then record them on microfilm or on photorecording paper. The computer output medium is merely changed from the more common output media of magnetic tape and tabulated listings to microfilm or photorecording paper. When this end product is the result of a complete computer program as outlined in D.2. the tax will not apply.

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2. In all situations where data is converted by means other than by the use of a complete computer program as outlined in D.2., the receipts for microfilming or photorecording are subject to sales tax. An example of this is where data on magnetic tape is converted into combinations of alphanumeric printing, curve plotting and/or line drawings and put on microfilm or photorecording paper.

(f) Non-taxable transactions.

1. Prewritten (canned) programs. These are programs prepared, held or existing for general or repeated use, including programs developed for in-house use and subsequently held or offered for sale or lease. The programs may be transferred to the customer in the form of punched cards, data on magnetic tape or by listing the program instructions on coding sheets. In some cases they are usable as written. However, in most cases it is necessary that the program be modified, adapted and tested to meet the customer's particular needs. The sale of all property, including coding sheets, cards or magnetic tape, on which or into which such prewritten (canned) programs have been coded, punched or otherwise recorded is not subject to tax. These items are classified as intangible personal property.

The tax does not apply whether title to the tape or other property upon which the program is coded, punched or otherwise recorded, passes to the customer, or the program is recorded on tape or other property furnished by the customer. The temporary transfer of possession of a program, for a consideration, for the purpose of direct use or to be recorded by the customer, is not a lease of tangible personal property and the tax does not apply. Where the consideration consists of license fees or royalty payments, all license fees or royalty payments, present or future, whether for a minimum use or for extended periods, are not includable in the measure of tax.

Programming changes to a prewritten program to adapt it to a customer's equipment, including translating a program to a language compatible with a customer's equipment, are not in the nature of fabrication or services that are part of a sale and, are not taxable.

Charges for assembler, compiler, utility and other prewritten programs provided to those who lease or purchase automatic processing equipment are not subject to tax.

2. Custom programs. These are programs prepared to the special order of a customer. This type of program is classified as intangible personal property, and is not subject to tax.

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MINNESOTA CODE OF AGENCY RULES

RULES OF THE DEPARTMENT OF REVENUE

1982 Reprint

All rules as in effect on September 15, 1982

Prepared by

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2001 (3) PARTNERSHIPS DEFINED.

The term "partnership" includes the following:

(a) syndicates

(b) groups

(c) pools

(d) joint ventures

(e) other unincorporated organizations through or by means of which any business, financial operation or venture is carried on and which is not, within the meaning of this Act, a trust, estate or corporation.

The term "partner" includes a member in such a syndicate, group, pool, joint venture or unincorporated organization.

Some of the characteristics which must be present in a partnership are enumerated as follows:

(1) An agreement between two or more parties to engage in a specific business or undertaking;

(2) an investment by each partner of capital or services, or both;

(3) a mutual right to contract debts in the name of the partnership;

(4) a mutual liability to the debts contracted;

(5) a right to an annual accounting and division of the profits or losses; and

(6) a termination of the partnership upon the death of a partner or upon a change in the ownership of a participating interest.

Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or a part ownership does not of itself establish a partnership whether such co-owners do or do not share any profits made by the use of the property. The sharing of gross returns does not of itself establish a partnership whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived.

An organization which is in form a partnership may be considered an association taxable as a corporation if (1) it is not interrupted by the death of a member or change in the ownership of a participating interest during the agreed period of its existence, and (2) its management is centralized in one or more persons in their representative capacities.

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2001 (4) CORPORATIONS DEFINED.

(a) **In general.**—The term "corporation" includes joint stock companies and corporations existing under the laws of any state or country; certain partnerships; associations (other than ordinary partnerships) and common law trusts organized or conducted for profit.

(b) **Certain partnerships classified as corporations.**—An organization which is in form a partnership may be considered an association taxable as a corporation if (1) it is not interrupted by the death of a member or change in the ownership of a participating interest during the agreed period of its existence, and (2) its management is centralized in one or more persons in their representative capacities.

If a partnership is classified as a "corporation," the income received by the members from the earnings of such partnership will be treated in their personal returns in the same manner as dividends from corporations.

(c) **Limited partnerships.**—For all taxable years beginning with and subsequent to 1939, a limited partnership is classified for the purpose of this Act as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership, notwithstanding other characteristics conferred upon it by local law.

(d) **Certain trusts classified as corporations.** — In cases where trustees hold property for the collection of the income and its distribution among the beneficiaries of the trust, the trust is not classified as a "corporation." Where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries but possess powers similar to those exercised by the directors in a corporation for the purpose of carrying on a business enterprise, the trust is classified as a "corporation." The distinction is that between the activity or purpose for which an ordinary, strict trust of the traditional type would be created and the activity or purpose for which a corporation for profit might have been formed.

2001 (7) RESIDENT DEFINED.

The term "resident" means any individual domiciled in Minnesota, and any other individual maintaining an abode therein during any portion of a tax year who shall, during any portion of such year, have been domiciled within the state.

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Residence, as defined in the Act, is practically synonymous with domicile. The residence of any person is held to be in that place in which his habitation is fixed, without any present intentions of removing therefrom, and to which, whenever he is absent, he intends to return.

A person who leaves his home to go into another state for temporary purposes only is not considered to have lost his residence. But if a person removes to another state with the intention of remaining there for an indefinite time as a place of permanent residence, he shall be considered to have lost his residence in this State.

The place where a man's family resides shall be considered his residence, and the residence of a wife is usually that of her husband, unless there is affirmative evidence to the contrary or unless the husband and wife are permanently separated. When a man has taken up his abode at any place with the intention of remaining there and his family neither resides with him nor intends to do so, then he shall be considered to have established a residence separate from that of his family.

The residence of a single man is his usual place of abode. In case of a minor child who is not emancipated, the residence of the child's father, or of the mother if the father is deceased, is the domicile of the child.

The mere intention to acquire a new residence, without the fact of removal, does not change the status of the taxpayer, nor does the fact of removal, without the intention to remain, change his status. The presumption is that one's domicile is the place where he lives. A domicile once shown to exist is presumed to continue until the contrary is shown. An absence of intention to abandon a residence is equivalent to an intention to retain the existing one. No positive rule can be adopted with respect to the evidence necessary to prove an intention to change a domicile but such intention may be proved by acts and declarations, and of the two forms of evidence, acts are generally conceded more weight than declarations. A person who is temporarily employed within the state does not acquire a residence in the state, if during such period he is domiciled without the state.

While the exercise of one's voting franchise is presumptive evidence of residence, such evidence may be overcome by a showing of the facts involved in the determination of residence. Casting an illegal vote does not of itself establish residence for income tax purposes.

2001 (8) FIDUCIARY DEFINED.

A fiduciary means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any position of peculiar confidence toward other persons or corporations.

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For income tax purposes a fiduciary is a person who holds in trust an estate to which another has the beneficial title or interest, or receives and controls the income of another, as in the case of receivers.

An agent is not necessarily a fiduciary, although a fiduciary relationship may exist between a principal and an agent. For instance, a real estate agent may be in complete control of the management of property with authority to execute leases and deal with tenants entirely on his own recognizance, periodically turning over the net proceeds from the rental of the property to his principal. Even though such agent receives this authority by virtue of power of attorney he is not a fiduciary within the meaning of the Act. In any case where business is transacted through the principle of agency, and no legal trust has been created, the liability under this Act to file returns rests with the principal.

2001 (20) GROSS INCOME.

(a) **In general.**—Income is the gain derived from capital (including profit or gain through the conversion of capital assets), from labor, or from both combined. Items of gross income must be included in gross income of the taxable year in which received by the taxpayer, unless properly accounted for as of a different taxable year.

(b) **Gross income to include income from sources outside of Minnesota.**—The term "gross income" in M.S.A. 290.01 (20) is not limited to gross income assignable to this State, but includes all gross income as defined in M.S.A. 290.01 (20) even though it was derived from sources without this State. For rules as to assigning such gross income see M.S.A. 290.17, 290.18, 290.19 and 290.20.

(c) **Compensation paid other than in cash.**—If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If a corporation transfers to its employees its own stock as compensation for services rendered by the employee, the amount of such compensation to be included in the gross income of the employee is the fair market value of the stock at the time of the transfer. If a person received as compensation for services rendered a salary and in addition thereto living quarters, see clause (d) below. The fair market value of notes or other evidence of indebtedness received in payment for services constitutes taxable income.

(d) **Compensation for personal services.**—Compensation for personal services includes in general: compensation for personal or professional services, salaries, wages, fees, and commissions, compensation for services based on a percentage of profits, commissions on insurance premiums, tips, and pay of persons in

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military or naval service (but see M.S.A. 290.08, Subd. 16 and 290.65, Subd. 1 for military pay provisions). Also includible are marriage fees, baptismal offerings, sums for saying masses for the dead, or other contributions received by a clergyman, evangelist, or religious worker for services rendered.

Salaries, wages, fees, commissions or other compensation received from the United States, its possessions, agencies, or its instrumentalities or of the State of Minnesota, its political or governmental subdivisions, municipalities, agencies, or instrumentalities, are includible in gross income.

Salaries received by Federal employees living in a "federal area" are includible in gross income.

(e) **Income from retirement and pensions funds.—**

(1) For the rule on amounts received from a retirement or pension fund of the United States or the State of Minnesota, see M.S.A. 290.08, Subd. 6 and Reg. 2008 (6).

(f) **Gross income from business.—**

(1) **In general.**—Gross income from business includes income from manufacturing, merchandising or mining. In the case of any such business, gross income means the total sales or receipts less the cost of goods purchased for resale, plus any income from investments and from incidentals or outside operations or sources. In determining the gross income, subtraction should not be made for any of the deductions from gross income allowed under the provisions of Chapter 290.

(2) **Creation of sinking fund by corporations.**—If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation, and any gain arising therefrom is income of the corporation and shall be included as such in its gross income.

(3) **Transfers to surplus included in gross income.**—Any amount transferred from a reserve or other account to surplus shall be included in gross income in the year in which the transfer was made but only if such amount was deducted from gross income or entered into the computation of net income in any taxable year ending after December 31, 1932, and provided further, to the extent that it reduced the tax imposed by this Act.

(g) **Gross income from farming.**—A taxpayer reporting farm income on the basis of receipts and disbursements (that is, not on an accrual basis) shall include in his gross income for the taxable

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year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of livestock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any livestock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of livestock or other items which were purchased after January 1, 1933, is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price, over the amount representing the difference between the cost and the depreciation theretofore allowed (but not less than the amount allowable) in respect of such property as a deduction in computing net income.

In the case of a taxpayer reporting farm income on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascertained by adding to the inventory value of livestock and products on hand at the end of the year the amount received from the sale of livestock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of livestock and products on hand at the beginning of the year and the cost of livestock and products purchased during the year. In such cases all livestock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also livestock acquired for draft, breeding, or dairy purposes and not for sale, may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In case of the sale of any livestock included in an inventory, their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory.

In the case of the sale of machinery, farm equipment, or other capital assets, the gain or loss therefrom is included in gross income in accordance with the provisions of M.S.A. 290.12, 290.13, 290.14, 290.15 and 290.16.

Proceeds received from hail and fire insurance resulting from damaged crops shall be included in gross income.

For the treatment of Commodity Credit Corporation loans as income, see M.S.A. 290.073 of the Act and also Reg. 2007.3.

(h) **Amounts derived from dealings in property.—**

(1) **In general.**—Amounts received from every kind of disposition of, or dealings in property is includible in gross income in accordance with the provisions of M.S.A. 290.12, 290.13, 290.14, 290.15 and 290.16.

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(2) **Sale of stock and rights.**—If shares of stock in a corporation are purchased at different dates or at different prices, and the identity of the lots cannot be determined, stock sold from such lots shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain. In the case of stock in respect of which any stock dividend has been paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles specified in Reg. 2014 (8). In any case where common stock is received as a bonus with a purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until the total cost shall have been recovered out of the proceeds of sales.

A distribution made by a corporation to its shareholders in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders. The same general rules apply as to the taxability in certain instances of stock dividends—see M.S.A. 290.01, Subd. 21.

In cases where the rights to acquire stock are not taxable, gain or loss may be sustained by the shareholder from the sale of such rights. In this connection the following rules may be stated:

(A) If the shareholder does not exercise, but sells his rights to subscribe, the cost or other basis of the stock in respect of which the rights are issued shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis assigned to the rights or the stock, divided, as the case may be, by the number of rights issued or by the number of shares held.

(B) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock in respect of which the rights were issued shall be determined as in paragraph (A). The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights, plus the subscription price of the new shares, by the number of new shares obtained.

If the stock in respect of which the rights are issued was purchased at different times or at different prices and the

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identity of the lot cannot be determined, or if the stock in respect of which the rights are issued was purchased at different times or at different prices and the stock rights issued in respect of any particular lot of such stock, the basis for determining the gain or loss from the sale of the old shares or the rights in cases where the rights are sold or from the sale of the old or new shares in cases where the rights are exercised, shall be ascertained in accordance with the principles laid down in Reg. 2014 (8).

Although interest on certain bonds and other obligations of the United States is exempt from taxation, except as noted in clause (i) of this regulation, gains and profits from the sale or other disposition of such bonds and obligations are taxable to the same extent as gains and profits from the sale or other disposition of other property.

(3) **Sale of patents and copyrights.**—A taxpayer disposing of patents or copyrights by sale or exchange should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other basis, with proper adjustment for depreciation as provided in Reg. 2009 (7).

(4) **Sale of good will.**—Gain or loss from a sale of good will results only when the business or part of it, to which the good will attaches, is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will.

(5) **Sale of real property in lots.**—If a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which consitutes taxable income may be returned as income for the year in which the sale is made. This rule contemplates that there will be gain or loss on every lot or parcel sold, and not that the capital in the entire tract may be recovered before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction, and gain or loss computed accordingly.

(6) **Acquisition or disposition by a corporation of its own capital stock.**—Whether the acquisition or disposition by the corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

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But, if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment has been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

(7) **Sale of capital assets by a corporation.**—If property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made, the gain from such sale, computed as provided in M.S.A. 290.12, 290.13, 290.14, 290.15, and 290.16. If the purchaser takes over all the assets and assumes the liability, the amount so assumed is part of the selling price.

(8) **Sale and purchase by a corporation of its bonds.—**

(A) (i) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (ii) If the corporation purchases any of such bonds, at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (iii) If, however, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(B) (i) If, subsequent to January 1, 1933, bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (ii) If the corporation purchases any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (iii) If, however, the corporation purchases any such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price, minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income), over the purchase price is gain or income for the taxable year.

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(C) (i) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (ii) If the corporation purchases any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (iii) If, however, the corporation purchases any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted), over the purchase price is gain or income for the taxable year.

(D) (i) If bonds were issued by a corporation prior to January 1, 1933, at a premium, the net amount of such premium was gain or income for the year in which the bonds were issued and should not be prorated or amortized over the life of the bonds. (ii) If the corporation purchases any of such bonds at a price in excess of the face value of the bonds, the excess of the purchase price over the face value is a deductible expense for the taxable year. (iii) If, however, the corporation purchases any of such bonds at a price less than the face value, the excess of the face value over the purchase price is gain or income for the taxable year.

With respect to the exclusion or deduction from gross income of income or expense attributable to the discharge of indebtedness in the case of corporations, concerning the taxable years after December 31, 1941, see M.S.A. 290.09, Subd. 12.

(i) **Interest.**—In general, all interest received is includible in gross income. Corporations taxable under M.S.A. 290.02, the excise tax provision of the Act, and banking corporations taxable under M.S.A. 290.361, must include in their taxable net income all interest received on obligations of the United States or its possessions, or the State of Minnesota, or any of their subdivisions, agencies, or instrumentalities. In an individual, fiduciary, or partnership return, interest from obligations of the United States or its possessions, or the State of Minnesota, or any of their subdivisions, agencies, or instrumentalities, is not includible in gross income (see M.S.A. 290.08, Subds. 7 and 8).

Interest received on annuities, life insurance or endowment contracts shall be treated in accordance with Reg. 2008 (4) and M.S.A. 290.08.

Interest is deemed to be received when accrued or when received depending upon the method of accounting used by the taxpayer. Interest becomes taxable to a taxpayer reporting on

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a cash basis when it is made available to him. Coupons on bonds which are due but have not been cashed are considered as received provided that the cash for payment of the coupons is available. Accrued interest paid on bonds purchased between interest payment dates shall be treated as a deduction from the interest received thereon. Accrued interest received on bonds sold between interest payment dates shall be treated as gross income.

Interest received from savings and loan and building and loan associations is includible in gross income even though such organizations may have been federalized.

In regard to the treatment of income from United States Government obligations issued at a discount, see M.S.A. 290.071, and also Reg. 2007.1 (1).

(j) Rent.—

(1) **In general.**—The gross amount of rents received from real estate located within Minnesota must be reported as Minnesota gross income regardless of the residence or domicile of the owner.

Rents received must be included in gross income when they accrue or when they are actually received by the taxpayer, depending upon the method of accounting used in reporting income. Rents which have not actually been received in cash will be considered as received if available to or subject to the disposition of the landlord.

Rents received from the United States Government for real estate located within Minnesota are includible in gross income.

(2) **Income to lessor corporation from leased property.** —If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability of the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the

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shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

(k) **Improvements by lessees.**—For all taxable years beginning on or after January 1, 1943, with respect to income derived by a lessor on real property upon termination of a lease, representing the value of such property attributable to buildings erected and other improvements made by the lessee, see M.S.A. 290.08 (13), Reg. 2008, Subd. 14, Reg. 2008 (14), and M.S.A. 290.14 (12), Reg. 2014 (12).

For all taxable years beginning on or before December 31, 1942, if buildings are erected or improvements made by a lessee and such betterments immediately become the property of the lessor, as for instance, if they are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon any one of the following bases:

(1) report as income for the taxable year in which such betterments are completed, the fair market value at the time of completion;

(2) report as income at the time when such betterments are completed, the fair market value of same subject to the lease;

(3) spread over the life of the lease the estimated depreciated value of same at the expiration of the lease and report as income each year of the lease an aliquot part thereof.

In the case of loss by fire or other casualty the lessor may deduct the amount previously reported as income because of the erection of such improvements less proper adjustment for depreciation in case option (1) was exercised and less the amount compensated for by insurance.

(l) **Annuities and insurance policies.**—Proceeds from annuities and insurance policies shall be governed as provided in M.S.A. 290.08, and Reg. 2008 (3), (4).

(m) **Income from discharge of indebtedness.**—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. Income is not realized by a taxpayer by virtue of the discharge of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of a composition agreement among his creditors if immediately thereafter the taxpayer's liabilities exceed the value of his assets.

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gain is considered a long-term capital gain for Federal income tax purposes, the modification shall be limited to fifty per centum of such portion of the gain;

(3) Interest or dividend income on securities to the extent exempt from income tax under the laws of this State authorizing the issuance of such securities but includible in gross income for Federal income tax purposes.

(C) Any amount received as a refund on account of State income taxes paid shall be deducted from Federal adjusted gross income.

(D) ADMINISTRATION EXPENSES— ESTATES.

(I) Amounts allowable under M.S.A. 291.07 (2) (relating to administration expenses) as deductions in computing the taxable estate of a decedent are not allowed as deductions in computing the taxable income of the estate unless there is filed a statement, in duplicate, to the effect that the items have not been allowed as deductions from gross estate of the decedent under M.S.A. 291.07 (2) and that all rights to have such items allowed at any time as deductions under M.S.A. 291.07 (2) are waived. The statement should be filed with the return for the year for which the items are claimed as deductions or with the Commissioner for association with the return. The statement may be filed at any time before the expiration of the statutory period of limitation applicable to the taxable year for which the deduction is sought. Allowance of the deduction in computing an estate's taxable income is not precluded by claiming a deduction in the inheritance tax return, so long as the inheritance tax deduction is not finally allowed and the statement is filed. However, after a statement is filed under M.S.A. 290.01, Subd. 20 (c) with respect to a particular item or portion of an item, the item cannot thereafter be allowed as a deduction for inheritance tax purposes since the waiver operates as a relinquishment of the right to have the deduction allowed at any time under M.S.A. 291.07 (2).

(II) It is not required that the total deductions, or the total amount of any deduction, to which M.S.A. 290.01, Subd. 20 (c) is applicable be treated in the same way. One deduction or portion of a deduction may be allowed for income tax purposes if the appropriate statement is filed, while another deduction or portion is allowed for inheritance tax purposes. M.S.A. 290.01, Subd. 20 (c) has no application to deductions for taxes, interest, business expenses, and other items accrued at the date of a decedent's death so that they are allowable as a deduction under M.S.A. 291.07-4 for inheritance tax purposes as claims against the

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estate, and are also allowable under M.S.A. 290.077, Subd. 2 as deductions in respect of a decedent for income tax purposes. However, M.S.A. 290.01, Subd. 20 (c) is applicable to deductions for interest, business expenses, and other items not accrued at the date of the decedent's death so that they are allowable as deductions for inheritance tax purposes only as administration expenses under M.S.A. 291.07. Although deductible under M.S.A. 291.07-4 in determining the value of the taxable estate of a decedent, medical, dental, etc., expenses of a decedent which are paid by the estate of the decedent are not deductible in computing the taxable income of the estate. [For additional modification of federal adjusted gross income by partners and shareholders of small business corporations see Regs. 2009 (23) 5, 6 and 7 and 2097.3 (3).]

(o) **Tax refunds included in gross income.**—Any amount received as a refund on account of tax paid shall be included in gross income in the year received to the extent that such taxes were deducted from gross income in any taxable year ending after December 31, 1932, provided, however, that the refund shall be included in gross income only to the extent that the deduction reduced the tax liability for a prior year. In the case where Federal income taxes withheld or declared are in excess of the amount actually due, the excess shall be considered as taxable income in the year in which received, subject to the provisions of this paragraph.

If in a taxable year after December 31, 1947, a husband and wife receive a refund of all or part of a Federal income tax paid by them on income reported in a joint Federal return, and if they had filed separate Minnesota returns for the taxable year in which they had paid such Federal income tax, the refund must be included in the return of the husband and wife in the same ratio that each was allowed the deduction for such Federal tax in their separate Minnesota returns.

(p) **Trust income taxable to the grantor as substantial owner thereof.**—Income of a trust is taxable to the grantor although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. See Reg. 2028.

(q) **Income derived from any source whatsoever.**—Income derived from any source whatsoever except as provided in this Act, and the Constitution of the State of Minnesota is includible in the gross income of the recipient.

Income from property acquired by gift, devise, bequest, or inheritance or a right to receive income is includible in gross income.

The value of merchandise taken from stock by a merchant for family use is includible in gross income.

The income derived from an illegal business is includible in gross income.

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gain is considered a long-term capital gain for Federal income tax purposes, the modification shall be limited to fifty per centum of such portion of the gain;

(3) Interest or dividend income on securities to the extent exempt from income tax under the laws of this State, authorizing the issuance of such securities but includible in gross income for Federal income tax purposes.

(C) Any amount received as a refund on account of State income taxes paid shall be deducted from Federal adjusted gross income.

(o) **Tax refunds included in gross income.**—Any amount received as a refund on account of tax paid shall be included in gross income in the year received to the extent that such taxes were deducted from gross income in any taxable year ending after December 31, 1932, provided, however, that the refund shall be included in gross income only to the extent that the deduction reduced the tax liability for a prior year. In the case where Federal income taxes withheld or declared are in excess of the amount actually due, the excess shall be considered as taxable income in the year in which received, subject to the provisions of this paragraph.

If in a taxable year after December 31, 1947, a husband and wife receive a refund of all or part of a Federal income tax paid by them on income reported in a joint Federal return, and if they had filed separate Minnesota returns for the taxable year in which they had paid such Federal income tax, the refund must be included in the return of the husband and wife in the same ratio that each was allowed the deduction for such Federal tax in their separate Minnesota returns.

(p) **Trust income taxable to the grantor as substantial owner thereof.**—Income of a trust is taxable to the grantor although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. See Reg. 2028.

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The value of merchandise taken from stock by a merchant for family use is includible in gross income.

The income derived from an illegal business is includible in gross income.

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Whenever doubt exists as to the taxability of income, a request for an opinion from the Commissioner of Taxation should be made, as failure to report taxable income because of lack of knowledge will not relieve a taxpayer from the penalties imposed by this Act.

(r) **Distributive share of partnership income.**—For rules on the inclusion in the gross income of a partner of his distributive share or partnership income, see M.S.A. 290.311 and the regulations thereunder.

(s) **Prizes and awards.**—For rules on the inclusion of prizes and awards in gross income, see M.S.A. 290.0801 and Reg. 2008.01.

(t) **Income from services of a child.**—For rules on the gross income from the services of a child, see M.S.A. 290.076 and Reg. 2007.6.

(u) **Alimony, separate maintenance payments, support payments.**—For rules on the inclusion of alimony, separate maintenance, or support payments in gross income, see M.S.A. 290.072.

(v) **Income in respect of a decedent.**—For rules on the inclusion in gross income of income received in respect of a decedent, see M.S.A. 290.077 and Reg. 2007.7 (1).

(w) **General exclusions—conflicts.**—The theory adopted by the 1961 Legislature involving utilization of Federal adjusted gross income as the basis for the imposition of income taxes upon individuals, estates and trusts results in conflicts between such theory and certain other provisions of Chapter 290. In these cases such conflicts will be resolved by considering that the provisions last passed by the Legislature control and in any event the theory of Federal adjusted gross income as a basis will be the governing factor.

2001 (21) DIVIDENDS.

(a) Dividends includible in gross income.

Dividends received on shares of stock in national and state banks, cooperative associations and personal service associations are taxable in the same manner as dividends received from any other source.

Amounts distributed to patrons as a net patronage refund in the form of certificates of capital stock or credits to reserve accounts or other accounts for the benefit of the patron are included in the gross income of the patron for the taxable year in which the certificates of capital stock are issued or the credit is actually or constructively received to the extent of the face value of the certificate of capital stock or of the credit.

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Dividends received from savings and loan and building and loan associations are includible in gross income even though such organizations may have been federalized.

(b) Method of taxation of shareholders of regulated investment companies.

(1) **In general.**—Shareholders who receive capital gain dividends from a regulated investment company distributed during a taxable year of the regulated investment company for which it is taxable under Section 852 (b) of the Internal Revenue Code of 1954 shall treat such dividends as gains from the sale or exchange of capital assets held for more than six months.

(2) **Definition of capital gain dividend.**—A capital gain dividend, as defined in Section 852 (b) (3) (C) of the Internal Revenue Code of 1954, is any dividend or part thereof which is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. If the aggregate amount so designated with respect to the taxable year is greater than the excess of the net long-term capital gain over the net short-term capital loss of the taxable year, the portion of each distribution which shall be a capital gain dividend shall be only that proportion of the amount so designated which such excess of the net long-term capital gain over the net short-term capital loss bears to the aggregate amount so designated. For example, a regulated investment company making its return on the calendar year basis advised its shareholders by written notice mailed December 30, 1955, that of a distribution of $500,000 made December 15, 1955, $200,000 constituted a capital gain dividend, amounting to $2 per share. It was later discovered that an error had been made in determining the excess of the net long-term capital gain over the net short-term capital loss of the taxable year and that such excess was $100,000 instead of $200,000. In such case each shareholder would have received a capital gain dividend of $1 per share instead of $2 per share.

2001 (22) TAXABLE NET INCOME.

(a) Taxable net income—individuals, estates and trusts.—In determining the taxable net income of individuals, estates and trusts in accordance with the provisions of M.S.A. 290.18, Subd. 1, there shall be taken into account only those items of deduction, exclusion, election or special treatment provided for by Chapter 290 which have not in any manner entered into the calculation of Federal adjusted gross income under the Internal Revenue Code applicable to the year in question. For example, inasmuch as the net operating loss computed in accordance with the provisions of the Internal Revenue Code is allowed in arriving at Federal adjusted gross income no further deduction is allowable

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under the provisions of M.S.A. 290.095. Conversely, inasmuch as the Internal Revenue Code does not permit the exclusion of the first $3,000 of compensation for personal service in the Armed Forces the provisions of M.S.A. 290.65 will be effective to permit such exclusion where applicable.

It should also be noted that inasmuch as the Internal Revenue Code makes provision for the deferment of any gain realized on the sale of a personal residence, under specified circumstances, which rules are substantially the same as those set forth in M.S.A. 290.13, Subd. 9, no further calculation or adjustment may be made in accordance with the provisions of this subdivision.

This principle may be illustrated by considering the matter of depreciation. Inasmuch as a depreciation allowance is given in determining Federal adjusted gross income no such allowance is to be again deducted under the provisions of M.S.A. 290.09, Subd. 7, even though the dollar amount of the allowance for Federal purposes may be different than the amount computed under Chapter 290. This rule applies also to depletion and other items of deduction spelled out in M.S.A. 290.09.

(b) **Apportionment of income between Minnesota and other states and countries.**—Taxpayers claiming an apportionment of income under M.S.A. 290.17, 290.18, 290.19, and 290.20 must establish to the satisfaction of the Commissioner that the character of their transactions and manner of the conduct of their affairs without Minnesota are such that they are entitled to an apportionment.

The fact that transactions may be effected without Minnesota does not necessarily mean that an apportionment of income is available to the taxpayer.

2002 EXCISE TAX.

The tax imposed by M.S.A. 290.02 is an excise or privilege tax measured for any given taxable year by the corporation's taxable net income for such year. The tax in the case of a domestic corporation is for the privilege of existing as a corporation during any part of a taxable year. The tax in the case of a foreign corporation is for the grant to it of the privilege of transacting, or for the actual transaction by it, of any local business within this State during any part of the taxable year. A foreign corporation qualified to do local business within this State, but whose transactions during a taxable year consist exclusively of interstate or foreign commerce or of both, is not taxable under this section, but is taxable under M.S.A. 290.03. A domestic corporation is taxable under the provisions of M.S.A. 290.03 if its business within this State consists exclusively of interstate or foreign commerce or of both. Any corporation, foreign or

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domestic, whose business is partly local and partly interstate or foreign is subject to the excise tax, even though the predominant part of its business is not local.

The provisions of M.S.A. 290.02 apply not only to corporations proper, but to certain other types of business organizations included in the definition of the term "corporation" in M.S.A. 290.01, Subd. 4.

2003 (1) INCOME TAX ON CORPORATIONS.

All corporations, domestic or foreign, whose business within this State during any taxable year consists exclusively of interstate commerce, are subject to a tax imposed directly upon their taxable net income under the provisions of M.S.A. 290.03 (1). This provision requires the imposition of a tax on the net income from interstate commerce or foreign commerce assignable to Minnesota.

The 1941 Legislature amended M.S.A. 290.03 (1) to include domestic and foreign corporations not taxable under M.S.A. 290.02 who own property within this State. Thus, although it may be established that a corporation is not transacting business within the state, the tax is imposed upon such corporation by this amendment if it owns property within the state. The provision "owning property in this State" is not limited to any particular kind of property such as real estate but includes all types of property.

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2007 (1) ANNUAL ACCOUNTING PERIOD.

(a) **In general.**—Net income and taxable net income shall be computed upon the basis of the taxpayer's annual accounting period, which is his taxable year.

The term "taxable year" means the period for which the taxes levied by the Act are imposed. It is a calendar year, fiscal year, or in cases where a return for a fractional part of a year is permitted or required, the period for which such return is made. (See M.S.A. 290.01, Subd. 9.)

The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. If, in a taxable year beginning after August 16, 1954, a taxpayer has made the election provided by M.S.A. 290.40 (2), the term means the annual period (varying from 52 to 53 weeks) so elected. (See M.S.A. 290.01, Subd. 10.) No fiscal year will be recognized unless it was definitely established as an accounting period by the taxpayer before its close, and the books of such taxpayer were kept in accordance therewith.

If a taxpayer has no annual accounting period, or has one other than a fiscal year, as defined above, the net income and taxable net income shall be computed on the basis of the calendar year. Taxpayers shall employ the same accounting period on which they are required to report their net income under the Federal Income Tax Act, but their right to change their accounting period is limited as set forth in M.S.A. 290.07, Subd. 1 and in paragraph (c) below.

A new taxpayer in his first return may adopt any taxable year which meets the requirements of M.S.A. 290.07, Subd. 1 and this regulation without obtaining prior approval. The first taxable year of a new taxpayer must be adopted on or before the time prescribed by law (not including extensions) for the filing of the return for such taxable year.

(b) **Partnerships and partners.**—A newly-formed partnership may adopt a taxable year which is the same as the taxable year of all its principal partners (or is the same taxable year to which its principal partners who do not have such taxable

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year concurrently change) without securing prior approval from the Commissioner. If all its principal partners are not on the same taxable year, a newly-formed partnership may adopt a calendar year without securing prior approval from the Commissioner. If a newly-formed partnership wishes to adopt a taxable year that does not qualify under the preceding two sentences, the adoption of such year requires the prior approval of the Commissioner in accordance with M.S.A. 290.31, Subd. 6 (2) and Reg. 2031 (6) (b) (1). An existing partnership may change its taxable year without securing prior approval from the Commissioner if all its principal partners have the same taxable year to which the partnership changes, or if all its principal partners who do not have such a taxable year concurrently change to such taxable year. In any other case, an existing partnership may not change its taxable year unless it secures the prior approval of the Commissioner in accordance with paragraph (c) of this regulation and M.S.A. 290.31, Subd. 6 (2) and Reg. 2031 (6) (b) (1).

A partner may change his taxable year only if he secures the prior approval of the Commissioner in accordance with paragraph (c) of this regulation.

(c) **Change of accounting period.**—A taxpayer may change his accounting period only with the consent of the Commissioner unless the change is otherwise authorized under these Regulations. However, any change must be to an accounting period which is the same as the accounting period on which the taxpayer is required to report his income under the Federal Income Tax Act.

The taxpayer may apply to the Commissioner of Taxation for permission to change his accounting period by

(1) Completing and filing Form 1Z4, or

(2) Attaching a statement to his return indicating that his accounting period has been changed for Federal income tax purposes.

If the taxpayer has been permitted by the Commissioner of Internal Revenue to change his accounting period, that fact should be stated in his application to the Minnesota Commissioner of Taxation. If application for such change has been made to the Commissioner of Internal Revenue but no action has been taken thereon, that fact should be stated in the taxpayer's application made to the Minnesota Commissioner of Taxation; in such case final action by the Minnesota Commissioner of Taxation will not be taken until consent has been either granted or denied by the Commissioner of Internal Revenue.

In the event permission to change his accounting period is secured from the Minnesota Commissioner of Taxation, the tax-

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payer shall pay a tax for such period not included in either his former or newly adopted taxable year. (For computation of tax, see M.S.A. 290.32.) The taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period.

2007 (2) ACCOUNTING METHODS.

Except as specifically provided to the contrary by this Act, net income and taxable net income shall be computed in accordance with the method of accounting regularly employed in keeping the taxpayer's books. Methods of accounting which are employed as standard for the kind of income producing activities in which the taxpayer is engaged, will ordinarily be regarded as clearly reflecting income. However, an accounting system which does not treat all items of gross income and all deductions with reasonable consistency, will not be regarded as clearly reflecting income. In such cases the computation shall be made in accordance with a method which, in the opinion of the Commissioner, clearly and fairly reflects income taxable under this Act. All items of gross income shall be included in the gross income of the taxable year in which received by a taxpayer, unless another method of accounting will more clearly reflect taxable income.

2007 (3) CHANGE IN ACCOUNTING METHODS.

The taxpayer must secure permission from the Commissioner to change his method of accounting or in reporting income and deductions. Such application must be filed within ninety days after the beginning of the taxable year to be covered by the return. A statement must be attached to the application setting forth in detail the variation in treatment of classes of items on the old and new basis. A change in the method of accounting or basis of reporting income and deductions means any change in the treatment of items of income and deductions such as change from cash receipts and disbursements basis to the accrual basis or vice versa; a change in the method of inventory valuations; or a change permitted by the Commissioner involving any other specialized method of accounting for income and deductions except bad debts, the treatment of which is set forth in Reg. 2009 (6).

For adjustments which are required when a change is made in an accounting method, see M.S.A. 290.07, Subd. 3.

2007 (4) RESTORATION OF AMOUNTS RECEIVED OR ACCRUED UNDER CLAIM OF RIGHT

(a) In general. (1) If, during the taxable year, the taxpayer is entitled under other provisions of Chapter 290 to a deduction of more than $3,000 because of the restoration to another of an

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item which was included in the taxpayer's gross income for a prior taxable year (or years) under a claim of right, the tax imposed by Chapter 290 for the taxable year shall be the tax provided in (b) of this regulation.

(2) For the purpose of this regulation "income included under a claim of right" means an item included in gross income because it appeared from all the facts available in the year of inclusion that the taxpayer had an unrestricted right to such item, and "restoration to another" means a restoration resulting because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item (or portion thereof).

(3) For purposes of determining whether the amount of a deduction described in M.S.A. 290.07, Subd. 4 exceeds $3,000 for the taxable year, there shall be taken into account the aggregate of all such deductions with respect to each item of income (described in M.S.A. 290.07, Subd. 4 of the same class.)

(b) Determination of tax. (1) Under the circumstances described in paragraph (a) of this section, the tax imposed by Chapter 290 for the taxable year shall be the lesser of—

(i) The tax for the taxable year computed under M.S.A. 290.07, Subd. 4 that is, with the deduction taken into account, or

(ii) The tax for the taxable year computed without taking such deduction into account, minus the decrease in tax (under Chapter 290 for the prior taxable year (or years) which would result solely from the exclusion from gross income of all or that portion of the income included under a claim of right to which the deduction is attributable. For the purpose of this subdivision, the amount of the decrease in tax is not limited to the amount of the tax for the taxable year. See (i) of this regulation where the decrease in tax for the prior taxable year (or years) exceeds the tax for the taxable year.

(2) If the taxpayer computes his tax for the taxable year under the provisions (ii) of (1) the amount of the restoration shall not be taken into account in computing taxable income or loss for the taxable year, including the computation of any net operating loss carryback or carryover or any capital loss carryover.

(3) If the tax determined under (1) (i) is the same as the tax determined under (1) (ii) the tax imposed for the taxable year under Chapter 290 shall be the tax determined under (1) (i), and this regulation shall not otherwise apply.

(c) Application to deductions which are capital in nature. M.S.A. 290.07, Subd. 4 and this regulation shall also apply to a deduction which is capital in nature otherwise allowable in the

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taxable year. If the deduction otherwise allowable is capital in nature, the determination of whether the taxpayer is entitled to the benefits of M.S.A. 290.07, Subd. 4 and this regulation shall be made without regard to the net capital loss limitation imposed by M.S.A. 290.16, Subd. 5. For example, if a taxpayer restores $4,000 in the taxable year and such amount is a long-term capital loss, the taxpayer will, nevertheless, be considered to have met the $3,000 deduction requirement for purposes of applying this regulation, although the full amount of the loss might not be allowable as a deduction for the taxable year. However, if the tax for the taxable year is computed with the deduction taken into account, the deduction allowable will be subject to the limitation on capital losses provided in M.S.A. 290.16, Subd. 5 and the capital loss carryover provided in M.S.A. 290.16, Subd. 6.

(d) Determination of decrease in tax for prior taxable years —(1) Prior taxable years. The prior taxable year (or years) referred to in (b) is the year (or years) in which the item to which the deduction is attributable was included in gross income under a claim of right and, in addition, any other prior taxable year (or years) the tax for which will be affected by the exclusion from gross income in such prior taxable year (or years) of such income.

(2) Amount of exclusion from gross income in prior taxable years. (i) The amount to be excluded from gross income for the prior taxable year (or years) in determining the decrease in tax under (b) (1) (ii) shall be the amount restored in the taxable year, but shall not exceed the amount included in gross income in the prior taxable year (or years) under the claim of right to which the deduction for the restoration is attributable, and shall be adjusted as provided in (ii) below.

(ii) If the amount included in gross income for the prior taxable year (or years) under the claim of right in question was reduced in such year (or years) by a deduction allowed under M.S.A. 290.16, Subd. 4 then the amount determined under (i) to be excluded from gross income for such year (or years) shall be reduced in the same proportion that the amount included in gross income under a claim of right was reduced.

(iii) The determination of the amount of the exclusion from gross income of the prior taxable year shall be made without regard to the capital loss limitation contained in M.S.A. 290.16, Subd. 5 applicable in computing taxable income for the current taxable year. The amount of the exclusion from gross income in a prior taxable year (or years) shall not exceed the amount which would, but for the application of M.S.A. 290.16, Subd. 5, be allowable as a deduction in the taxable year of restoration.

(iv) The rule provided in subdivision (iii) of this subparagraph may be illustrated as follows:

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Example. For the taxable year 1957, an individual taxpayer had long-term capital gains of $50,000 and long-term capital losses of $10,000, a net long-term gain of $40,000. He also had other income of $5,000. In 1961 taxpayer restored the $50,000 of long-term gain. He had no capital gains or losses in 1961 but had other income of $5,000. If his tax liability for 1961, the taxable year of restoration, is computed by taking the deduction into account, the taxpayer would be entitled to a deduction under M.S.A. 290.16, Subd. 5 of only $1,000 on account of the capital loss. However, if the taxpayer computes his tax under (b) (1) (ii), it is necessary to determine the decrease in tax for 1957. In such a determination, $50,000 is to be excluded from gross income for that year, resulting in a net capital loss for that year of $10,000, and a capital loss deduction of $1,000 under M.S.A. 290.16, Subd. 5 with carryover privileges. The difference between the tax previously determined and the tax as recomputed after such exclusion for the years affected will be the amount of the decrease.

(3) Determination of amount of deduction attributable to prior taxable years. (i) If the deduction otherwise allowable for the taxable year relates to income included in gross income under a claim of right in more than one prior taxable year and the amount attributable to each such prior taxable year cannot be readily identified, then the portion attributable to each such prior taxable year shall be that portion of the deduction otherwise allowable for the taxable year which the amount of the income included under the claim of right in question for the prior taxable year bears to the total of all such income included under the claim of right for all such prior taxable years.

(ii) The rule provided in (i) may be illustrated as follows:

Example. Under a claim of right, A included in his gross income over a period of three taxable years an aggregate of $9,000 for services to a certain employer, in amounts as follows: $2,000 for taxable year 1952, $4,000 for taxable year 1953, and $3,000 for taxable year 1954. In 1955 it is established that A must restore $6,750 of these amounts to his employer, and that A is entitled to a deduction of this amount in the taxable year 1955. The amount of the deduction attributable to each of the prior taxable years cannot be identified. Accordingly, the amount of the deduction attributable to each prior taxable year is:

$$1952 — \$6{,}750 \times \frac{\$2{,}000}{\$9{,}000} = \$1{,}500$$

$$1953 — \$6{,}750 \times \frac{\$4{,}000}{\$9{,}000} = \$3{,}000$$

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$$1954 - \$6{,}750 \times \frac{\$3{,}000}{\$9{,}000} = \$2{,}250$$

(4) Computation of amount of decrease in tax. (i) In computing the amount of decrease in tax for a prior taxable year (or years) resulting from the exclusion from gross income of the income included under a claim of right, there must first be ascertained the amount of tax previously determined for the taxpayer for such prior taxable year (or years). The tax previously determined shall be the sum of the amounts shown by the taxpayer on his return or returns, plus any amounts which have been previously assessed (or collected without assessment) as deficiencies or which appropriately should be assessed or collected, reduced by the amount of any refunds or credits which have previously been made or which appropriately should be made. After the tax previously determined has been ascertained, a recomputation must then be made to determine the decrease in tax, if any, resulting from the exclusion from gross income of all or that portion of the income included under a claim of right to which the deduction otherwise allowable in the taxable year is attributable.

(ii) No item other than the exclusion of the income previously included under a claim of right shall be considered in computing the amount of decrease in tax if reconsideration of such other item is prevented by the operation of any provision of the income tax laws or any other rule of law. However, if the amounts of other items in the return are dependent upon the amount of adjusted gross income, taxable income, or net income (such as charitable contributions, foreign tax credit, deductions for depletion, and net operating loss), appropriate adjustment shall be made as part of the computation of the decrease in tax. For the purpose of determining the decrease in tax for the prior taxable year (or years) which would result from the exclusion from gross income of the item included under a claim of right, the exclusion of such item shall be given effect not only in the prior taxable year in which it was included in gross income but in all other prior taxable years affected by the inclusion of the item (for example, prior taxable years affected by a net operating loss carryback or carryover or capital loss carryover).

(iii) The rules provided in this subparagraph may be illustrated as follows:

Example (1) For the taxable year 1954, a corporation has taxable income of $35,000, on which it paid a tax of $2,000. Included in gross income for the year was $20,000 received under a claim of right as royalties. In 1957, the corporation is required to return $10,000 of the royalties. It otherwise has taxable income in 1957 of $5,000, so that without the application of M.S.A. 290.07, Subd. 4 it has a net operating loss of $5,000 in that year.

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Facts also come to light in 1957 which entitle the corporation to an additional deduction of $5,000 for 1954. When a computation is made under 1 (b) (1) (i), the corporation has no tax for the taxable year 1957. When a computation is made under 1 (b) (ii), the tax for 1957, without taking the restoration into account, is $365, based on a taxable income of $5,000. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		$ 2,000
Taxable income for 1954 upon which tax shown on return was based		35,000
Less: Additional deduction (on account of which credit or refund could be made)		5,000
Total		30,000
Tax on $30,000 (adjusted taxable income for 1954)		1,715
Taxable income for 1954, as adjusted	$30,000	
Less exclusion of amount restored	10,000	
Taxable income for 1954 by applying 1 (b) (1) (ii)	20,000	
Tax on $20,000		1,145
Decrease in tax for 1954 by applying 1 (b) (1) (ii)		570
Tax for 1957 without taking the restoration into account		365
Amount by which decrease exceeds the tax for 1957 computed without taking restoration into account		205

(The $205 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1957 and is available as a refund. In addition the taxpayer has made an overpayment of $285 ($2,000 less $1,715) for 1954 because of the additional deduction of $5,000.)

Example (2). Assume the same facts as in example (1) except that, instead of the corporation being entitled to an additional deduction of $5,000 for 1954, it is determined that the corporation failed to include an item of $5,000 in gross income for that year. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		$ 2,000
Taxable income for 1954 upon which tax shown on return was based		35,000

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Plus: Additional income (on account of which deficiency assessment could be made)		5,000
Total		40,000
Tax on $40,000 (adjusted taxable income for 1954)		2,285
Tax on $40,000 (adjusted taxable income for 1954)		2,285
Taxable income for 1954 as adjusted	$40,000	
Less exclusion of amount restored	10,000	
Taxable income for 1954 by applying 1 (b) (1) (ii)	30,000	
Tax on $30,000		1,715
Decrease in tax for 1954 by applying 1 (b) (1) (ii)		570
Tax for 1957 without taking the restoration into account		365
Amount by which decrease exceeds the tax for 1957 computed without taking the restoration into account		205

(The $205 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1957 and is available as a refund. In addition the taxpayer has a deficiency of $285 ($2,285 less $2,000) for 1954 because of the additional income of $5,000.)

(e) Method of accounting. The provisions of M.S.A. 290.07, Subd. 4 and this regulation shall be applicable in the case of a taxpayer on the cash receipts and disbursements method of accounting only to the taxable year in which the item of income included in a prior year (or years) under a claim of right is actually repaid. However, in the case of a taxpayer on the cash receipts and disbursements method of accounting who constructively received an item of income under a claim of right and included such item of income in gross income in a prior year (or years), the provisions of M.S.A. 290.07, Subd. 4 and this regulation shall be applicable to the taxable year in which the taxpayer is required to relinquish his right to receive such item of income. Such provisions shall be applicable in the case of other taxpayers only to the taxable year which is the proper taxable year (under the method of accounting used by the taxpayer in computing taxable income) for taking into account the deduction resulting from the restoration of the item of income included in a prior year (or years) under a claim of right. For example, if the taxpayer is on an accrual method of accounting, the provisions of this section shall apply to the year in which the obligation properly accrues for the repayment of the item included under a claim of right.

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(f) Inventory items, stock in trade, and property held primarily for sale in the ordinary course of trade or business. (1) Except for amounts specified in subparagraph (2) of this paragraph the provisions of M.S.A. 290.07, Subd. 4 and this regulation do not apply to deductions attributable to items which were included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. This regulation is, therefore, not applicable to sales returns and allowances and similar items.

(2) The provisions of M.S.A. 290.07, Subd. 4 and this regulation apply to deductions which arise out of refunds or repayments made by a regulated public utility, as defined in Section 1503 (c) (1) or (3) of the Internal Revenue Code of 1954 and Sec. 1.1502-2 (g), of the Federal Tax Regulations, if such refunds or repayments are required to be made by the government, political subdivision, agency, or instrumentality referred to in such regulation. Thus, deductions attributable to refunds of charges for the sale of natural gas under rates approved temporarily by a proper governmental authority are eligible for the benefits of M.S.A. 290.07, Subd. 4 and this regulation, if such refunds are required by the governmental authority.

(g) Bad debts. The provisions of M.S.A. 290.07, Subd. 4 and this regulation do not apply to deductions attributable to bad debts.

(h) Legal fees and other expenses. M.S.A. 290.07, Subd. 4 and this regulation do not apply to legal fees or other expenses incurred by a taxpayer in contesting the restoration of an item previously included in income. This rule may be illustrated by the following example:

Example. A sold his personal residence to B in a prior taxable year and realized a capital gain on the sale. C claimed that under an agreement with A he was entitled to a 5-percent share of the purchase price since he brought the parties together and was instrumental in closing the sale. A rejected C's demand and included the entire amount of the capital gain in gross income for the year of sale. C instituted action and in the taxable year judgment is rendered against A who pays C the amount involved. In addition, A pays legal fees in the taxable year which were incurred in the defense of the action. M.S.A. 290.07, Subd. 4 applies to the payment of the 5-percent share of the purchase price to C. However, the payment of the legal fees, whether or not otherwise deductible, does not constitute an item restored for purposes of M.S.A. 290.07, Subd. 4.

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(i) Refunds. If the decrease in tax for the prior taxable year (or years) determined under M.S.A. 290.07, Subd. 4 and (b) (1) (ii) of this regulation exceeds the tax imposed by Chapter 290 for the taxable year computed without the deduction, the excess shall be considered to be a payment of tax for the taxable year of the deduction. Such payment is deemed to have been made on the last day prescribed by law for the payment of tax for the taxable year and shall be refunded or credited in the same manner as if it were an overpayment of tax for such taxable year.

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2007 (6)-1 GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

(a) General Rule. Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. To the extent that income is attributable to the recovery of bad debts for accounts charged off in prior years, it is includible in the year of recovery in accordance with the taxpayer's method of accounting, regardless of the date when the amounts were charged off. For treatment of bad debts and bad debt recoveries, see M.S.A. 290.09, Subd. 6 and the regulations thereunder. For the year in which a partner must include his distributive share of partnership income, see M.S.A. 290.31, Subd. 6 (1) and regulations thereunder. If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due. Similarly, if a taxpayer ascertains that an item was improperly included in gross income in a prior taxable year, he should, if within the period of limitation, file claim for credit of refund of any overpayment of tax arising therefrom.

(b) Special Rule In Case Of Death. (1) A taxpayer's taxable year ends on the date of his death. See M.S.A. 290.40 (1) and regulations thereunder. In computing taxable income for such year, there shall be included only amounts properly includible under the method of accounting used by the taxpayer. However, if the taxpayer used an accrual method of accounting, amounts accrued only by reason of his death shall not be included in computing taxable income for such year. If the taxpayer uses no regular accounting method, only amounts actually or constructively received during such year shall be included. (For rules re-

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lating to the inclusion of partnership income in the return of a decedent partner, see M.S.A. 290.31 and the regulations thereunder.)

(2) If the decedent owned an installment obligation the income from which was taxable to him under M.S.A. 290.07, Subd. 5, no income is required to be reported in the return of the decedent by reason of the transmission at death of such obligation.

For the treatment of installment obligations acquired by the decedent's estate or by any person by bequest, devise, or inheritance from the decedent, see M.S.A. 290.077, Subd. 1 (4).

2007 (6)-2 CONSTRUCTIVE RECEIPT OF INCOME

(a) General Rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipts is subject to substantial limitations or restrictions. Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

(b) Examples Of Constructive Receipt. Interest coupons which have matured and are payable but which have not been cashed are constructively received in the taxable year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. Dividends on corporate stock are constructively received when unqualifiedly made subject to the demand of the shareholder. However, if a dividend is declared payable on December 31 and the corporation followed its usual practice of paying the dividends by checks mailed so that the shareholders would not receive them until January of the following year, such dividends are not considered to have been constructively received until January. Interest on savings bank deposits is income to the depositor when credited on the books of the bank, even though the bank has a rule, seldom or never enforced, that it may require a certain number of days' notice before withdrawals are permitted. Generally, the amount of dividends or interest credited to shareholders of organizations such as building and loan associations or cooperative banks, is income to the shareholders for the taxable year when credited. However, if the amount of such dividends or interest is not available for the shareholders' free and unrestricted use at the time credited, such amount is not constructively received and does not constitute income to the shareholder until the taxable year in which the amount is available. Accordingly, if the amount of dividends or interest is accumulated and is not available to the shareholder until the maturity of a share, the

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crediting thereof to the shareholder's account does not constitute constructive receipt. However, in such a case the total amount credited is income to the shareholder in the year of maturity.

2007 (6)-3 LONG-TERM CONTRACTS

(a) Definition. The term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted.

(b) Methods. Income from long-term contracts (as defined in paragraph (a) of this section), determined in a manner consistent with the nature and terms of the contract, may be included in gross income in accordance with one of the following methods, provided such method clearly reflects income:

(1) Percentage of completion method. Gross income derived from long-term contracts may be reported according to the percentage of completion method. Under this method, the portion of the gross contract price which corresponds to the percentage of the entire contract which has been completed during the taxable year shall be included in gross income for such taxable year. There shall then be deducted all expenditures made during the taxable year in connection with the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable year for use in such contract. Certificates of architects or engineers showing the percentage of completion of each contract during the taxable year shall be available at the principal place of business of the taxpayer for inspection in connection with an examination of the income tax return.

(2) Completed Contract Method. Gross income derived from long-term contracts may be reported for the taxable year in which the contract is finally completed and accepted. Under this method, there shall be deducted from gross income for such year all expenses which are properly allocable to the contract, taking into account any material and supplies charged to the contract but remaining on hand at the time of completion.

(c) In General. Long-term contract methods of accounting apply only to the accounting for income and expenses attributable to long-term contracts. Other income and expense items, such as investment income or expenses not attributable to such contracts, shall be accounted for under a proper method of accounting. See M.S.A. 290.07, Subd. 2 and regulations thereunder. A taxpayer may change to or from a long-term contract method of accounting only with the consent of the Commissioner. See M.S.A. 290.-07, Subd. 2 and regulations thereunder. When a taxpayer reports income under a long-term contract method, a statement to that effect shall be attached to his income tax return.

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2007 (6)-4 ACCOUNTING FOR REDEMPTION OF TRADING STAMPS AND COUPONS

(a) If a taxpayer issues trading stamps or premium coupons with sales, which stamps or coupons are redeemable in merchandise or cash, he should, in computing the income from such sales, subtract only the amount which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users of trading stamps or premium coupons engaged in similar businesses. The taxpayer shall file a statement showing with respect to each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, the following:

(1) The total issue of stamps or coupons during each year:

(2) The total stamps or coupons redeemed in each year: and

(3) Such other information as is necessary to establish the correctness of the amount subtracted from sales in each of such years.

(b) Upon examination of the return, the amount subtracted in respect of such coupons will be adjusted if, in the opinion of the Commissioner, such amount is incorrectly computed.

2007 (7) TIME FOR TAKING DEDUCTIONS AND CREDITS.

(a) **In general.**—Taxpayers should endeavor to ascertain all the facts necessary to make a correct return for each year. The return should be complete in itself, both as to gross income and deductions. The expenses of one year cannot be used to reduce the income of a subsequent year. If a taxpayer does not avail himself of the deductions authorized by the Act for the year in which such deductions should be taken, he cannot charge them against the income of any other year.

Adjudications which are binding upon the taxpayer, such as decisions under workmen's compensation laws, or judgments on account of damages for patent infringement, personal injuries, or other causes, are deductible from gross income when the claim is adjudicated if the taxpayer is reporting on an accrual basis, or when the claim is paid if the taxpayer is on the cash basis. In determining the extent of such deductions the amount shall be reduced by insurance or other compensation received.

If a taxpayer cannot ascertain the amount of a loss in the year in which it was sustained, but subsequently determines the amount of such loss, he may file a claim for refund under the provisions of M.S.A. 290.50 for the year during which the loss actually occurred, if the statute of limitations set out in M.S.A.

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290.50 has not expired. However, losses arising from theft shall be treated as sustained in the taxable year in which the taxpayer discovers the theft. (See M.S.A. 290.09, Subd. 5.)

For tax treatment of periodic payments of alimony, separate maintenance, or support by a divorced or separated spouse, see M.S.A. 290.072 and 290.09, Subd. 14.

Deductions and credits accrued only by reason of the death of the taxpayer shall not be allowed in computing the net income of the taxpayer for the period in which falls the date of the taxpayer's death. See Reg. 2007.7 (2).

(b) **"Paid or incurred" and "paid or accrued."**—The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. The deductions and credits provided for in M.S.A. 290.09 and 290.21 must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period.

Interest received on refunds of taxes shall be included in gross income for the year received regardless of the method of bookkeeping employed by the taxpayer.

(c) Contested Liabilities. With respect to taxable years beginning after December 31, 1964, if the taxpayer contests an ascertained liability but nevertheless causes the payment of said liability and such liability, except for the contest, would be a property deduction, then said payment shall be deductible for the year of such payment or for an earlier taxable year.

2007.1 (1) TREATMENT OF INCOME FROM OBLIGATIONS OF UNITED STATES ISSUED AT A DISCOUNT.

The earned increment arising from obligations of the United States issued at a discount and redeemable for fixed amounts increasing at stated intervals constitutes interest received from United States government obligations and is exempt from gross income of all taxpayers other than corporations. (See M.S.A. 290.08, Subd. 8.) Such earned increment will not be taxed as a capital gain when the obligation is disposed of, redeemed, or paid at maturity but will constitute taxable interest received to all corporations in accordance with the provisions of M.S.A. 290.08, Subd. 13.

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For all taxable years beginning after December 31, 1940, a corporate taxpayer, even though it employs the cash basis as the method of computing its net income, may, at its election, treat the increase in redemption price occurring during the taxable year as income for such taxable year or at its election treat such increase as income in the year in which the obligations are disposed of, redeemed, or paid at maturity. Once such election is made no change in accounting therefor is permitted, unless application is made to the Commissioner and his permission is granted to change to a different method of reporting income from such obligations.

2007.1 (5) RECOVERY OF BAD DEBTS.

For all taxable years beginning after December 31, 1942, the recovery of all or part of a bad debt constitutes income only to the extent that a tax benefit resulted in a prior year.

To illustrate, assume that in 1943 a corporate taxpayer's taxable net income was $500 after deducting a $1,200 bad debt. Since the taxpayer was entitled to a specific credit of $1,000 in 1943, it was apparent that there was no tax benefit from $500 of the total bad debt deduction of $1,200. If the taxpayer recovers $250 in 1946 and $500 in 1947, such taxpayer may exclude the total $250 recovery in 1946 and $250 of the $500 recovery in 1947. The balance of the 1947 recovery and any subsequent recovery must be included in gross income.

If the taxpayer uses the reserve method, recoveries of bad debts previously charged against the reserve are not income as such but are credits to the reserve, thus decreasing the amount of addition to the reserve for the current year necessary to bring it up to a reasonable amount. It is this addition to the reserve which is deductible on the income tax return.

2007.3 COMMODITY CREDIT LOANS.

Prior to the 1943 Amendment, when a producer of agricultural commodities pledged them as security for a loan from the

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Commodity Credit Corporation, he was required to include the amount of these loans in his gross income for the year in which the security for the loan was sold. Under the 1943 Amendment for all taxable years beginning with 1942, a taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received or for the taxable year in which the security is sold. When the taxpayer makes such an election, then he shall be bound by that election for all taxable years, unless he secures the permission of the Commissioner of Taxation to change to a different method of accounting. Application for permission to change the method of accounting and the basis upon which such return is made shall be filed within ninety days after the beginning of the taxable year to be covered by the return.

If the taxpayer elects, he may report the income in the taxable year in which the security is sold rather than the year in which the loan is received. In that case, the income realized from the disposition of such security constitutes income for that taxable year.

If a taxpayer elects under M.S.A. 290.073 to include in his gross income the amount of a loan from the Commodity Credit Corporation for the taxable year in which it is received, then

(1) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives an amount in addition to that advanced to him as the loan, in which event such additional amount shall be included in the gross income of the taxpayer for the year in which received; and

(2) No deductible loss to the taxpayer shall be recognized on account of any deficiency realized by the Commodity Credit Corporation on such loan if the taxpayer was relieved of liability for such deficiency.

Example: A, a taxpayer who elected for his taxable years 1942 and 1943, to include in gross income amounts received during those years as loans from the Commodity Credit Corporation, received as loans $500.00 in 1942 and $700.00 in 1943. In 1944 all of the pledged commodity was sold by the Commodity Credit Corporation for an amount of $200.00 less than the loan with respect to the commodity pledged in 1942 and for an amount of $150.00 greater than the loan with respect to the commodity pledged in 1943. A, in making his return for 1944, shall include in gross income the sum of $150.00 if it is received during that year, but will not be allowed a deduction for the deficiency of $200.00 unless he is required to satisfy such deficiency and does satisfy it during that year.

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2007.5 RENEGOTIATED WAR CONTRACTS.

A taxpayer who supplies goods, wares or merchandise, or performs services, or both, under a contract with the United States of America, or under a subcontract thereunder, or any agency thereof, and who is subject to renegotiation under the laws of the United States of America, or is required to renegotiate with his subcontractor, shall compute his tax liability without giving consideration to any adjustment of excessive profits renegotiated subsequent to the close of the taxable year.

In any case where a final determination of renegotiation has been completed subsequent to the close of any taxable year, the taxpayer shall be entitled to claim as a deduction from gross income in the year in which the determination is made the difference between (1) the amount determined to be excessive profits, and (2) the amount of Federal income and excess profits taxes applicable thereto. An example of this computation is shown in the following schedule:

Taxable net income—Year 1952 (before any adjustment for renegotiation or Federal income taxes paid)		$10,000,000.00
Federal income and excess profits taxes paid		5,000,000.00
Net		$ 5,000,000.00
Excess profits finally determined in 1952, applicable to the year 1951	$ 5,000,000.00	
Less applicable Federal income and excess profits taxes on above	2,500,000.00	
Difference deductible		2,500,000.00
Taxable net income for the year 1952 on which tax is to be computed		$ 2,500,000.00

In any case where a final determination of renegotiation has been completed subsequent to the close of the taxable year, and the net income for the year in which such final determination is made, computed without regard thereto, is less than the amount deductible as a result thereof as shown in the preceding example, the taxpayer shall be entitled to a refund of any state income and excise taxes paid, to the extent they were paid on or measured by the excess of (1) the amount which would be deductible as a result of such determination (as shown in the preceding example) over (2) the taxable net income computed without regard to such determination. An example of this computation is shown as follows:

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Taxable net income—Year 1951 (before any adjustments for renegotiation or Federal income taxes paid)		$11,000,000.00
Federal income and excess profits taxes paid (For year 1950)		7,000,000.00
Net		$ 4,000,000.00
Excessive profits finally determined in 1953, applicable to the year 1951	$10,000,000.00	
Less applicable Federal income and excess profits taxes on above	5,000,000.00	
Net renegotiated profits	$ 5,000,000.00	
Taxable net income year 1953 before renegotiation	4,000,000.00	
Amount of renegotiated profits deductible in year 1953	4,000,000.00	
Excess of difference over the amount of taxable net income		1,000,000.00
State income and excise taxes computed on $1,000,000.00		54,000.00
Amount of refund of 1951 State income and excise taxes to which taxpayer is entitled		$ 54,000.00

The foregoing computations are based on the assumption that the taxpayer's entire taxable net income is assignable to Minnesota.

The following example illustrates a computation of taxable net income in cases where the total net income is subject to apportionment by formula:

Taxable net income—Year 1952 (before any adjustment for renegotiation)		$20,000,000.00
Percentage of net income assignable to Minnesota	25%	
Minnesota taxable net income—Year 1952 (before any adjustment for renegotiation)		$ 5,000,000.00
Less excessive profits renegotiated and finally determined in 1952—applicable to year 1951	$10,000,000.00	
Deduct Federal income and excess profits taxes applicable to above	6,000,000.00	
Net renegotiated profits	$ 4,000,000.00	
Percentage of taxable net income assigned to Minnesota—Year 1951	15%	

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Amount of net renegotiated profits deductible from Minnesota net income—Year 1952.....	600,000.00
Minnesota taxable net income—Year 1952.....	$ 4,400,000.00

2008 (2) GIFTS AND INHERITANCES

(a) General Rule. Property received as a gift, or received under a will or under statutes of descent and distribution, is not includible in gross income, although the income from such property is includible in gross income. An amount of principal paid under a marriage settlement is a gift. However, see M.S.A. 290.-072 and the regulations thereunder for rules relating to alimony or allowances paid upon divorce or separation. M.S.A. 290.08, Subd. 2 does not apply to prizes and awards (see M.S.A. 290.0801 and 2008.01) nor to scholarships and fellowship grants (see M.-S.A. 290.08, Subd. 18 and the regulations thereunder).

(b) Income From Gifts And Inheritances. The income from any property received as a gift, or under a will or statute of descent and distribution shall not be excluded from gross income under paragraph (a) of this section.

(c) Gifts And Inheritances Of Income. If the gift, bequest, devise, or inheritance is of income from property, it shall not be excluded from gross income under paragraph (a) of this section. M.S.A. 290.08, Subd. 2 provides a special rule for the treatment of certain gifts, bequests, devises, or inheritances which by their terms are to be paid, credited, or distributed at intervals. Except as provided in M.S.A. 290.23, Subd. 10 (1) (a) and paragraph (d) of this section, to the extent any such gift, bequest, devise, or inheritance is paid, credited, or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property. M.S.A. 290.08, Subd. 2 provides the same treatment for amounts of income from property which is paid, credited, or to be distributed under a gift or bequest whether the gift or bequest is in terms of a right to payments at intervals (regardless of income) or is in terms of a right to income. To the extent the amounts in either case are paid, credited, or to be distributed at intervals out of income, they are not to be excluded under M.S.A. 290.08, Subd. 2 from the taxpayer's gross income.

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(d) Effect of M.S.A. 290.23, 290.25, 290.26, 290.27 and 290.28. Any amount required to be included in the gross income of a beneficiary under M.S.A. 290.23, Subds. 7, 9, and 14 shall be treated for purposes of this section as a gift, bequest, devise, or inheritance of income from property. On the other hand, any amount excluded from the gross income of a beneficiary under M.S.A. 290.23, Subd. 10 (1) (a) shall be treated for purposes of this section as property acquired by gift, bequest, devise, or inheritance.

(e) Income Taxes To Grantor Or Assignor. M.S.A. 290.08, Subd. 2 is not intended to tax a donee upon the same income which is taxed to the grantor of a trust or assignor of income under M.S.A. 290.01, Subd. 20 or M.S.A. 290.25, 290.26, 290.27 or 290.28.

2008 (8) INCOME FROM THE UNITED STATES.

Salaries, wages, fees, commissions or compensation received after December 31, 1938, from the United States, its possessions, its agencies, or its instrumentalities are includible in gross income.

For taxable years beginning after December 31, 1940, salaries, wages, fees, commissions or other compensation received from the United States, its possessions, its agencies or its instrumentalities by Federal employees residing in "federal areas" are includible in gross income.

Interest upon obligations of the United States and its possessions is generally not includible in the gross income of the recipient. However, in the case of a corporation which is taxable under the franchise tax provision of M.S.A. 290.02 such interest must be included in gross income. In other words, every corporation taxable under M.S.A. 290.02 must include in its gross income interest received from the United States which would otherwise be exempt from tax under M.S.A. 290.08 Subd. 8.

Gains derived from the sale of United States bonds and other tax exempt securities are taxable.

With respect to obligations of the United States, issued at a discount and redeemable for fixed amounts increasing at stated intervals, see M.S.A. 290.071, Subd. 1, and Reg. 2007.1 (1).

Dividends received from national banks constitute taxable income to all taxpayers after January 1, 1940.

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2008 (12) PATRONAGE DIVIDENDS.

The amount of patronage dividends distributed by cooperative associations is not includible in the gross income of such associations. Such dividends, however, are includible in the gross income of the recipient.

The term patronage dividends includes patronage rebates, refunds and credits. (See Reg. 2001 (21).)

2008 (14) IMPROVEMENTS BY LESSEE ON LESSOR'S PROPERTY.

For taxable years beginning after December 31, 1942, income derived by a lessor of real property upon the termination, through forfeiture or otherwise, of the lease of such property and attributable to buildings erected or other improvements made by the lessee upon the leased property is excluded from gross income. However, where the facts disclose that such buildings or improvements represent in whole or in part a liquidation in kind of lease rentals, the exclusion from gross income shall not apply to the extent that such buildings or improvements represent such liquidation. The exclusion applies only with respect to the income realized by the lessor upon the termination of the lease and has no application to income, if any, in the form of rent which may be derived by a lessor during the period of the lease and attributable to buildings erected or other improvements made by the lessee. It has no application to income which may be realized by the lessor upon the termination of the lease but not attributable to the value of such buildings or improvements. Neither does it apply to income derived by the lessor subsequent to the termination of the lease incident to the ownership of such buildings and improvements.

The provisions of this regulation may be illustrated by the following example:

The A Corporation leased in 1936 for a period of fifty years unimproved real property to the B Corporation under a lease providing that the B Corporation erect on the leased premises an office building costing $500,000, in addition to paying the A Corporation a lease rental of $10,000 per annum beginning on the date of completion of the improvements, the sum of $100,000 being placed in escrow for the payment of the rental. The building was completed on January 1, 1938. The lease provided that all improvements made by the lessee on the leased property would become the absolute property of A Corporation on the termination of the lease by forfeiture or otherwise and that the lessor would become entitled on such termination to the remainder of the sum, if any, remaining in the escrow fund. The B Corporation forfeited its lease on January 1, 1943, when the improvements had a value of $100,000. Under the provisions of M.S.A. 290.08 Subd. 14, the $100,000 is excluded from gross income. The amount of $50,000 representing the remainder in the

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escrow fund is forfeited to the A Corporation and is included in the gross income of that taxpayer. If, in this example, the lease covered a period of only twenty-five years and the building upon completion had an estimated value of $75,000 as of the end of the lease term and in accordance with an option granted by the regulations the A Corporation included in gross income the sum of $3,000 for each taxable year from 1938 to 1942, both years inclusive, then there shall be excluded from gross income for the taxable year 1943 and subsequent taxable years any such amounts otherwise includible in gross income for such years and attributable to the building erected by the B Corporation, notwithstanding the exercise of such option.

As to the basis of the property in the hands of the lessor, see M.S.A. 290.14 (12) and Reg. 2014 (12).

2008 (19) CONTRIBUTIONS TO CAPITAL OF CORPORATION

In the case of a corporation, M.S.A. 290.08, Subd. 19 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. M.S.A. 290.08, Subd. 19 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production. See M.S.A. 290.136, Subd. 8 for the basis of property acquired by a corporation through a contribution to its capital by its stockholders or by non-stockholders.

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2008 (25) INCOME ACCRUED PRIOR TO JANUARY 1, 1933.

Where an interest bearing claim which existed unconditionally on December 31, 1932 is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The basis for the determination of loss or gain in such cases, shall be the same as provided in M.S.A. 290.15.

Interest which has accrued prior to January 1, 1933 shall be included in ascertaining the cost or fair market value of the claim. Interest accruing on or after that date is taxable income.

In any case where services were rendered prior to January 1, 1933, and the taxpayer had an unconditional assignable right on that date to compensation for such services, the fair market value on January 1, 1933 of the combined amount of the principal of the claim and any interest which had then accrued is exempt from tax. The excess of the amount received over such fair market value is taxable income. The value of an insurance policy on January 1, 1933 represented by the reserve liability and dividend accumulations apportioned to it as of that date on the books of the insurance company, may be used as a basis for the purpose of ascertaining the gain derived from its subsequent sale or other disposition. In the case of interest on corporate bonds, where the liability to pay became absolute before January 1, 1933, even though it was not payable until after that date, such interest is not includible in gross income.

2009 PROCEDURE FOR DETERMINING ALLOWABLE DEDUCTIONS.

To determine to what extent, if at all, an item is allowable as a deduction, several tests must be applied. The general procedure is as follows:

(a) First the item must qualify as a deduction listed in M.S.A. 290.09.

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(b) If the item meets the above test, it then must be determined whether the deduction is allowable in its entirety, only in part, or not at all.

(1) If the taxpayer has income which is not assignable to the State of Minnesota, certain deductions may not be allowable or may be allowable only in part (see M.S.A. 290.18 and the regulations thereunder).

(2) If the taxable net income from a trade or business is to be computed under M.S.A. 290.19, deductions are allowable in accordance with the formula set forth in that section.

(3) If the taxpayer has income not included in the measure of the Minnesota Income Tax, deductions allocable against the production or receipt of such income may not be allowable (see M.S.A. 290.10 (9) and the regulations thereunder).

(c) After it is determined that a deduction is allowable in its entirety or in part, the deduction is then considered under M.S.A. 290.18, Subd. 2. This subdivision states which deductions may be used in computing adjusted gross income.

2009 (2)-1 BUSINESS EXPENSES.

(a) In General. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than M.S.A. 290.09, Subd. 2. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See Reg. 2001 (20) (f). Among the items included in business expenses are management expenses, commissions (but see M.S.A. 290.09, Subds. 16, 17 and 21 and the regulations thereunder), labor, supplies, incidental repairs, operating expenses of automobiles, traveling expenses while away from home solely in the pursuit of a trade or business (see Reg. 2009 (2)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. No such items shall be included in business expenses however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business.

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(b) Cross References. (1) For charitable contributions by individuals and corporations not deductible under M.S.A. 290.09, Subd. 2, see Reg. 2009 (2)-15.

(2) For items not deductible see M.S.A. 290.10, inclusive, and regulations thereunder.

(3) For research and experimental expenditures, see M.S.A. 290.09, Subd. 18 and regulations thereunder.

(4) For soil and water conservation expenditures, see M.S.A. 290.09, Subd. 21 and regulations thereunder.

2009 (2)-2 TRAVELING EXPENSES

(a) Traveling expenses include travel fares, meals and lodging, and expenses incident to travel such as expenses for sample rooms, telephone and telegraph, public stenographers, etc. Only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel, are business expenses.

(b) (1) If a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination. However, expenses while at the destination which are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible.

(2) Whether a trip is related primarily to the taxpayer's trade or business or is primarily personal in nature depends on the facts and circumstances in each case. The amount of time during the period of the trip which is spent on personal activity compared to the amount of time spent on activities directly relating to the taxpayer's trade or business is an important factor in determining whether the trip is primarily personal. If, for example, a taxpayer spends one week while at a destination on activities which are directly related to his trade or business and subsequently spends an additional five weeks for vacation or other personal activities, the trip will be considered primarily personal in nature in the absence of a clear showing to the contrary.

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(c) Where a taxpayer's wife accompanies him on a business trip, expenses attributable to her travel are not deductible unless it can be adequately shown that the wife's presence on the trip has a bona fide business purpose. The wife's performance of some incidental services does not cause her expenses to qualify as deductible business expenses. The same rules apply to any other members of the taxpayer's family who accompany him on such a trip.

(d) Expenses paid or incurred by a taxpayer in attending a convention or other meeting may constitute an ordinary and necessary business expense under M.S.A. 290.09, Subd. 2, depending upon the facts and circumstances of each case. No distinction will be made between self-employed persons and employees. The fact that an employee uses vacation or leave time or that his attendance at the convention is voluntary will not necessarily prohibit the allowance of the deduction. The allowance of deduction for such expenses will depend upon whether there is a sufficient relationship between the taxpayer's trade or business and his attendance at the convention or other meeting so that he is benefiting or advancing the interests of his trade or business by such attendance. If the convention is for political, social or other purposes unrelated to the taxpayer's trade or business, the expenses are not deductible.

(e) Commuters' fares are not considered as business expenses and are not deductible.

(f) For rules with respect to the reporting and substantiation of traveling and other business expenses of employees for taxable years beginning after December 31, 1958, see Reg. 2009 (2)-14.

2009 (2)-3 COST OF MATERIALS

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method.

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2009 (2)-4 REPAIRS

The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer's plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, shall either be capitalized and depreciated in accordance with M.S.A. 290.09, Subd. 7 (A) or charged against the depreciation reserve if such an account is kept.

2009 (2)-5 EXPENSES FOR EDUCATION.

(a) Expenditures made by a taxpayer for his education are deductible if they are for education (including research activities) undertaken primarily for the purpose of:

(1) Maintaining or improving skills required by the taxpayer in his employment or other trade or business, or

(2) Meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment.

Whether or not education is the type referred to in subparagraph (1) of this paragraph shall be determined upon the basis of all the facts of each case. If it is customary for other established members of the taxpayer's trade or business to undertake such education, the taxpayer will ordinarily be considered to have undertaken this education for the purpose described in subparagraph (1) of this paragraph. Expenditures for education of the type described in subparagraph (2) of this paragraph are deductible under subparagraph (2) only to the extent that they are for the minimun education required by the taxpayer's employer, or by applicable law or regulations, as a condition to the retention of the taxpayer's salary, status, or employment. Expenditures for education other than those so required may be deductible under subparagraph (1) of this paragraph if the education meets the qualifications of subparagraph (1). A taxpayer is considered to have made expenditures for education to meet the express requirements of his employer only if the requirement is imposed primarily for a bona fide business purpose of the taxpayer's employer and not primarily for the taxpayer's benefit. Except as provided in the last sentence of paragraph (b) of this section, in the case of teachers, a written statement from an authorized official or school officer to the effect that the education was re-

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quired as a condition to the retention of the taxpayer's salary, status, or employment will be accepted for the purpose of meeting the requirements of this paragraph.

(b) Expenditures made by a taxpayer for his education are not deductible if they are for education undertaken primarily for the purpose of obtaining a new position or substantial advancement in position, or primarily for the purpose of fulfilling the general educational aspirations or other personal purposes of the taxpayer. The fact that the education undertaken meets express requirements for the new position or substantial advancement in position will be an important factor indicating that the education is undertaken primarily for the purpose of obtaining such position or advancement, unless such education is required as a condition to the retention by the taxpayer of his present employment. In any event, if education is required of the taxpayer in order to meet the minimum requirements for qualification or establishment in his intended trade or business or specialty therein, the expense of such education is personal in nature and therefore is not deductible.

(c) In general a taxpayer's expenditures for travel (including travel while on sabbatical leave) as a form of education shall be considered as primarily personal in nature and therefore not deductible.

(d) If a taxpayer travels away from home primarily to obtain education the expenses of which are deductible under this section, his expenditures for travel, meals, and lodging while away from home are deductible. However, if as an incident of such trip the taxpayer engages in some personal activity such as sightseeing, social visiting or entertaining, or other recreation, the portion of the expenses attributable to such personal activity constitutes nondeductible personal or living expenses and is not allowable as a deduction. If the taxpayer's travel away from home is primarily personal, the taxpayer's expenditures for travel, meals, and lodging (other than meals and lodging during the time spent in participating in deductible educational pursuits) are not deductible. Whether a particular trip is primarily personal or primarily to obtain education the expenses of which are deductible under this section depends upon all the facts and circumstances of each case. An important factor to be taken into consideration in making the determination is the relative amount of time devoted to personal activity as compared with the time devoted to educational pursuits. Expenses in the nature of commuters' fares are not deductible.

(e) The provisions of this section may be illustrated by the following examples:

Example (1). A is employed by an accounting firm. In order to become a certified public accountant he takes courses in ac-

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counting. Since the education was undertaken prior to the time A became qualified in his chosen profession as a certified public accountant, A's expenditures for such courses and expenses for any transportation, meals, and lodging while away from home are not deductible.

Example (2). B, a general practitioner of medicine, takes a course of study in order to become a specialist in pediatrics. C, a general practitioner of medicine, takes a 2-week course reviewing developments in several specialized fields, including pediatrics, for the purpose of carrying on his general practice. B's expenses are not deductible because the course of study qualified him for a specialty within his trade or business. C's expenses for his education and any transportation, meals, and lodging while away from home are deductible because they were undertaken primarily to improve skills required by him in his trade or business.

Example (3). D is required by his employer (or by State law) either to read a list of books or to take certain courses giving six hours academic credit every two years in order to retain his position as a teacher. D fulfills the requirement by taking the courses and thereby receives an automatic increase in salary in his present position and salary schedule. Also, as the result of taking the prescribed courses, at the end of ten years, D receives a master's degree and becomes automatically eligible for an additional salary increase. Since D's purpose in taking the courses was primarily to fulfill the educational requirement of his employer, his expenses for such education and transportation, meals, and lodging while away from home are deductible.

Example (4). The facts are the same as in example (3) except that, due solely to a shortage of qualified teachers, D's employer does not enforce the prescribed educational requirements in that other teachers who do not fulfill those requirements are retained in their positions. D's expenses are nevertheless deductible.

Example (5). E, a high school teacher of physics, in order to improve skills required by him and thus improve his effectiveness as such a teacher, takes summer school courses in nuclear physics and educational methods. E's expenses for such courses are deductible.

Example (6). F takes summer school courses in order to improve skills required by him in his employment as a teacher. As a result of taking such courses F receives an ingrade increase in salary in his present position pursuant to a salary schedule established by the school system for which he works. F's expenditures for such courses are deductible.

Example (7). G, a graduate student at a university, plans to become a university professor. In order to qualify as a regular

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faculty member, G must obtain a graduate degree. While taking the required graduate courses, G is engaged in teaching at the university. G's expenses therefore are not deductible since he has not completed the education required to become qualified as a regular faculty member at the time he takes such courses.

Example (8). H, a self-employed tax consultant, decides to take a 1-week course in taxation, which is offered in City X, 500 miles away from his home. His primary purpose in going to X is to take the course, but he also takes a side trip to City Y (50 miles from X) for one day, takes a sightseeing trip while in X, and entertains some personal friends. H's transportation expenses to City X and return to his home are deductible but his transportation expenses to City Y are not deductible. H's expenses for meals and lodging while away from home will be allocated between his educational pursuits and his personal activities. Those expenses which are entirely personal such as sightseeing and entertaining friends, are not deductible to any extent.

Example (9). The facts are the same as in example (8) except that H's primary purpose in going to City X is to take a vacation. This purpose is indicated by several factors, one of which is the fact that he spends only one week attending the tax course and devotes five weeks entirely to personal activities. None of H's transportation expenses are deductible and his expenses for meals and lodging while away from home are not deductible to the extent attributable to personal activities. His expenses for meals and lodging allocable to the week attending the tax course are, however, deductible.

2009 (2)-6 PROFESSIONAL EXPENSES

A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid or accrued in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid or accrued for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistance. Amounts currently paid or accrued for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

2009 (2)-7 COMPENSATION FOR PERSONAL SERVICES

(a) There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services,

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(b) The test set forth in paragraph (a) of this section and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation in only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

(4) For disallowance of deduction in the case of certain transfers of stock pursuant to employees stock options, see M.S.A. 290.078 and the regulations thereunder.

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2009 (2)-8 TREATMENT OF EXCESSIVE COMPENSATION

The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stockholdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price. In the absence of evidence to justify other treatment, excessive payments for salaries or other compensation for personal services will be included in gross income of the recipient.

2009 (2)-9 BONUSES TO EMPLOYEES

Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or which are in excess of reasonable compensation for services, are not deductible from gross income.

2009 (2)-10 CERTAIN EMPLOYEE BENEFITS

(a) In General. Amounts paid or accrued by a taxpayer on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. Amounts paid or accrued within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, welfare, or similar benefit plan, are deductible under M.S.A. 290.09, Subd. 2 (a) if they are ordinary and necessary expenses of the trade or business. However, except as provided in paragraph (b) of this section, such amount shall not be deductible under M.S.A. 290.09, Subd. 2 (a) if, under any circumstances, they may be used to provide benefits under a stock bonus, pension, annuity, profit-sharing, or other deferred compensation plan of the type referred to in M.S.A. 290.26. In such an event, the extent to which these amounts are deductible from gross income shall be governed by the provisions of M.S.A. 290.26 and the regulations issued thereunder.

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(b) Certain Negotiated Plans. Subject to the limitations set forth in subparagraphs (2) and (3) of the paragraph, contributions paid by an employer under a plan under which such contributions are held in a welfare trust for the purpose of paying (either from principal or income or both) for the benefit of employees, their families, and dependents, at least medical or hospital care, and pensions on retirement or death of employees, are deductible when paid as business expenses under M.S.A. 290.09, Subd. 2 (a).

(c) Other Plans Providing Deferred Compensation. For rules relating to the deduction of amounts paid to or under a stock bonus, pension, annuity, or profit-sharing plan or amounts paid or accrued under any other plan deferring the receipt of compensation, see M.S.A. 290.26 and the regulations thereunder.

2009 (2)-11 RENTALS

(a) If a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. For disallowance of deduction for income taxes paid by a lessee corporation, see section 110 of the Internal Revenue Code of 1954 and the regulations thereunder.

(b) (1) The cost to a lessee of erecting buildings or making permanent improvements on property of which he is the lessee is a capital investment, and is not deductible as a business expense. If the estimated useful life in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, this deduction shall be computed under the provisions of M.S.A. 290.09, Subd. 7 (A) (relating to depreciation). Where there is a possibility that the lease may be renewed, the matter of spreading such costs over the term of the original lease, together with the renewal period or periods, depending upon the facts in the particular case, including the presence or absence of an option of renewal and the relationship between the parties. As a general rule, unless the lease has been renewed or the facts show with reasonable certainty that the lease will be renewed, the cost or other basis of the lease, or the cost of improvements shall be spread only over the number of years the lease has to run without taking into account any right of renewal.

(2) Subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). A subsidiary corporation leases land from its parent at a fair rental for a 25-year period. The subsidiary erects on the land valuable factory buildings having a normal useful

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life of 50 years. These facts show with reasonable certainty that the lease will be renewed, even though the lease contains no option of renewal. Therefore, the cost of the buildings shall be depreciated over the estimated useful life of the buildings in accordance with M.S.A. 290.09, Subd. 7 (A) and the regulations thereunder.

Example (2). A retail merchandising corporation leases land at a fair rental from an unrelated lessor for the longest period that the lessor is willing to lease the land (30 years). The lessee erects on the land a department store having a normal useful life of 40 years. These facts do not show with reasonable certainty that the lease will be renewed. Therefore, the cost of the building shall be spread over the remaining term of the lease. An annual deduction may be made in an amount equal to the cost of the building divided by the number of years remaining in the term of the lease, and such deduction shall be in lieu of a deduction for depreciation.

2009 (2)-12 EXPENSES OF FARMERS

A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. The purchase of feed and other costs connected with raising livestock may be treated as expense deductions insofar as such costs represent actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may, with the consent of the Commissioner (as M.S.A. 290.07, Subd. 2 and the regulations thereunder), be determined upon the crop method, and such deductions must be taken in the taxable year in which the gross income from the crop has been realized. If a farmer does not compute income upon the crop method, the cost of seeds and young plants which are purchased for further development and cultivation prior to sale in later years may be deducted as an expense for the year of purchase, provided the farmer follows a consistent practice of deducting such costs as an expense from year to year. The preceding sentence does not apply to the cost of seeds and young plants connected with the planting of timber. See M.S.A. 290.09, Subd. 8 and the regulations thereunder. The cost of farm machinery, equipment, and farm buildings represent a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. For the treatment of soil and water conservation expenditures as expenses which

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are not chargeable to capital account, see M.S.A. 290.09, Subd. 21 and the regulations thereunder. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with Reg. 2001 (20) (g). The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of farm products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. (See Reg. 2001-20 (9), 2009 (8) and M.S.A. 290.09, Subd. 5.

2009 (2)-13 EXCEPTED CONTRIBUTIONS

(a) No deduction is allowable under M.S.A. 290.09, Subd. 2 (a) for a contribution or gift by an individual or a corporation if any part thereof is deductible under M.S.A. 290.21. For example, if a taxpayer makes a contribution of $5,000 and only $4,000 of this amount is deductible under M.S.A. 290.21, no deduction is allowable under M.S.A. 290.09, Subd. 2 (a) for the remaining $1,000.

(b) The limitations provided in this section apply only to payments which are in fact contributions or gifts to organizations described in M.S.A. 290.21. For example, payments by a street railway company to a local hospital (which is a charitable organization within the meaning of M.S.A. 290.21) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the company's employees are not contributions or gifts within the meaning of M.S.A. 290.21 and may be deductible under M.S.A. 290.09, Subd. 2 (a) if the requirements of M.S.A. 290.09, Subd. 2 (a) are otherwise satisfied. Donations to organizations other than those described in M.S.A. 290.21 which bear a direct relationship to the taxpayer's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway company may donate a sum of money to an organization (of a class not referred to in M.S.A. 290.21) intending to hold a convention in the city in which it operated, with

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a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

2009 (2)-14 REPORTING AND SUBSTANTIATION OF TRAVELING AND OTHER BUSINESS EXPENSES OF EMPLOYEES

(a) Introductory. The purpose of the regulations in this section is to provide rules for the reporting of information on income tax returns by taxpayers who pay or incur ordinary and necessary business expenses in connection with the performance of services as an employee and to furnish guidance as to the type of records which will be useful in compiling such information and in its substantiation, if required. The rules prescribed in this section do not apply to expenses paid or incurred for incidentals, such as office supplies for the employer or local transportation in connection with an errand. Employees incurring such incidental expenses are not required to provide substantiation for such amounts. The term "ordinary and necessary business expenses" means only these expenses which are ordinary and necessary in the conduct of the taxpayer's business and are directly attributable to such business. The term does not include nondeductible personal, living or family expenses.

(b) Expenses For Which The Employee Is Required To Account To His Employer—(1) Reimbursements equal to expenses. The employee need not report on his tax return (either itemized or in total amount) expenses for travel, transportation, entertainment, and similar purposes paid or incurred by him solely for the benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer (for example, through credit cards) or for which the employee is paid through advances, reimbursements, or otherwise provided the total amount of such advances, reimbursements, and charges is equal to such expenses. In such a case the taxpayer need only state in his return that the total of amounts charged directly or indirectly to his employer through credit cards or otherwise and received from the employer as advances or reimbursements did not exceed the ordinary and necessary business expenses paid or incurred by the employee.

(2) Reimbursements In Excess Of Expenses. In case the total of amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, exceeds the ordinary and necessary business expenses paid or incurred by the employee and the employee is required to and does account to his employer for such expenses, the taxpayer must include such excess in income and state on his return that he has done so.

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(3) Expenses In Excess Of Reimbursements. If the employee's ordinary and necessary business expenses exceed the total of the amounts charged directly or indirectly to the employer and received from the employer as advances, reimbursements, or otherwise, and the employee is required to and does account to his employer for such expenses, the taxpayer may make the statement in his return required by subparagraph (1) of this paragraph unless he wishes to claim a deduction for such excess. If, however, he wishes to secure a deduction for such excess, he must submit a statement showing the following information as part of his tax return:

(i) The total of any charges paid or borne by the employer and of any other amounts received from the employer for payment of expenses whether by means of advances, reimbursements or otherwise; and

(ii) The nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

(4) To "account" to his employer as used in this section means to submit an expense account or other required written statement to the employer showing the business nature and the amount of all the employee's expenses (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses and other business expenses. For this purpose, the Commissioner in his discretion may approve reasonable business practices under which mileage, per diem in lieu of subsistence, and similar allowances providing for ordinary and necessary business expenses in accordance with a fixed scale may be regarded as equivalent to an account to the employer.

(c) Expenses For Which The Employee Is Not Required To Account To His Employer. If the employee is not required to account to his employer for his ordinary and necessary business expenses, e.g., travel, transportation, entertainment, and similar items, or, though required fails to account for such expenses, he must submit, as a part of his tax return, a statement showing the following information:

(1) The total of all amounts received as advances or reimbursements from his employer in connection with the ordinary and necessary business expenses of the employee, including amounts charged directly or indirectly to the employer through credit cards or otherwise; and

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(2) The nature of his occupation, the number of days away from home on business, and the total amount of ordinary and necessary business expenses paid or incurred by him (including those charged directly or indirectly to the employer through credit cards or otherwise) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses.

(d) Substantiation Of Items Of Expenses. (1) Although the Commissioner may require any taxpayer to substantiate such information concerning expense accounts as may appear to be pertinent in determining tax liability, taxpayers ordinarily will not be called upon to substantiate expense account information except those in the following categories:

(i) A taxpayer who is not required to account to his employer, or who does not account;

(ii) A taxpayer whose expenses exceed the total of amounts charged to his employer and amounts received through advances, reimbursements or otherwise and who claims a deduction on his return for such excess;

(iii) A taxpayer who is related to his employer within the meaning of section 267 (b) of the Internal Revenue Code of 1954; and

(iv) Other taxpayers in cases where it is determined that the accounting procedures used by the employer for the reporting and substantiation of expenses by employees are not adequate.

(2) The Minnesota Income Tax Act contemplates that taxpayers keep such records as will be sufficient to enable the Commissioner to correctly determine income tax liability. Accordingly, it is to the advantage of taxpayers who may be called upon to substantiate expense account information to maintain as adequate and detailed records of travel, transportation, entertainment, and similar business expenses as practical since the burden of proof is upon the taxpayer to show that such expenses were not only paid or incurred but also that they constitute ordinary and necessary business expenses. One method of substantiating expenses incurred by an employee in connection with his employment is through a preparation of a daily diary or record of expenditures, maintained in sufficient detail to enable him to readily identify the amount and nature of any expenditure, and the preservation of supporting documents, especially in connection with large or exceptional expenditures. Nevertheless, it is recognized that by reason of the nature of certain expenses or the circumstances under which they are incurred, it is often difficult for an employee to maintain detailed records or to preserve supporting

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documents for all his expenses. Detailed records of small expenditures incurred in traveling or for transportation, as for example, tips, will not be required.

(3) Where records are incomplete or documentary proof is unavailable, it may be possible to establish the amount of the expenditures by approximations based upon reliable secondary sources of information and collateral evidence. For example, in connection with an item of traveling expense a taxpayer might establish that he was in a travel status a certain number of days but that it was impracticable for him to establish the details of all his various items of travel expense. In such a case rail fares or plane fares can usually be ascertained with exactness and automobile costs approximated on the basis of mileage covered. A reasonable approximation of meals and lodging might be based upon receipted hotel bills or upon average daily rates for such accommodations and meals prevailing in the particular community for comparable accommodations. Since detailed records of incidental items are not required, deductions for these items may be based upon a reasonable approximation. In cases where a taxpayer is called upon to substantiate expense account information, the burden is on the taxpayer to establish that the amounts claimed as a deduction are reasonably accurate and constitute ordinary and necessary business expenses paid or incurred by him in connection with the trade or business. In connection with the determination of factual matters of this type, due consideration will be given to the reasonableness of the stated expenditures for the claimed purposes in relation to the taxpayer's circumstances (such as his income and the nature of his occupation), to the reliability and accuracy of records in connection with other items more readily lending themselves to detailed record-keeping, and to all of the facts and circumstances in the particular case.

2009 (2)-15 NONTRADE OR NONBUSINESS EXPENSES

(a) An expense may be deducted under M.S.A. 290.09, Subd. 2 (b) only if—

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income, which, if and when realized, will be required to be included in income for Minnesota income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income, or (iii) in connection with the determination, collection, or refund of any tax; and

(2) It is an ordinary and necessary expense for any of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purpose of M.S.A. 290.09, Subd. 2 (b) includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or

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may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includable in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter paid or incurred in connection with such bonds are deductible. Similarly, ordinary and necessary expenses paid or incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under M.S.A. 290.09, Subd. 2 (b) even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.

(c) Expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case. For example, consideration will be given to the record of prior gain or loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

(d) Expenses, to be deductible under M.S.A. 290.09, Subd. 2 (b), must be "ordinary and necessary". Thus, such expenses must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(e) A deduction under M.S.A. 290.09, Subd. 2 (b) is subject to the restrictions in M.S.A. 290.10, relating to items not deductible. Thus, no deduction is allowable under M.S.A. 290.09, Subd. 2 (b) for any amount allocable to the production or collection of one or more classes of income which are not includable in gross income, or for any amount allocable to the management, conservation or

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maintenance of property held for the production of income which is not included in gross income. Nor does M.S.A. 290.09, Subd. 2 (b) allow the deduction of any expenses which are disallowed by any of the provisions of M.S.A. Chapter 290, even though such expenses may be paid or incurred for one of the purposes specified in M.S.A. 290.09, Subd. 2 (b).

(f) Among expenditures not allowable as deductions under M.S.A. 290.09, Subd. 2 (b) are the following: Commuter's expenses; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; expenses such as those paid or incurred in seeking employment or in placing oneself in a position to begin rendering personal services for compensation, bar examination fees and other expenses paid or incurred in securing admission to the bar, and corresponding fees and expenses paid or incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions.

(g) Fees for services of investment counsel, custodial fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under M.S.A. 290.09, Subd. 2 (b) only if (1) they are paid or incurred by the taxpayer for the production or collection of income or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment.

(h) Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.

(i) Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under M.S.A. 290.09, Subd. 2 (b), notwithstanding that the estate or trust is not engaged in a trade or business, except to the extent that such expenses are allocable to the production or collection of tax-exempt income.

(j) Reasonable amounts paid or incurred for the services of a guardian or committee for a ward or minor, and other expenses of guardians and committees which are ordinary and necessary, in connection with the production or collection of income inuring

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to the ward or minor, or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the ward or minor, are deductible.

(k) Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of which, if when recovered, must be included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenses paid or incurred in protecting or asserting one's rights to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible.

(l) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of his tax liability or in contesting his tax liability are deductible.

(m) An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

(n) Capital expenditures are not allowable as nontrade or nonbusiness expenses. The deduction of an item otherwise allowable under M.S.A. 290.09, Subd. 2 (b) will not be disallowed simply because the taxpayer was entitled under M.S.A. Chapter 290 to treat such item as a capital expenditure, rather than to deduct it as an expense. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in M.S.A. Chapter 290, no deduction is allowable under M.S.A. 290.09, Subd. 2 (b); and this is true regardless of whether any basis adjustment is allowed under any other provision of M.S.A. Chapter 290.

(o) The provisions of M.S.A. 290.09, Subd. 2 (b) are not intended in any way to disallow expenses which would otherwise be allowable under M.S.A. 290.09, Subd. 2 (a) and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the M.S.A. Chapter 290 cannot again be deducted under any other provision thereof.

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2009 (2) 16 Political campaign expenditures.—

(1) **In general.** Campaign expenditures of a candidate for public office are deductible, subject to a schedule of maximum deductions, from gross income (A) if such expenditures were personally paid by the candidate, and (B) if such expenditures were not subsequently reimbursed, and (C) if the candidate complied with the expenditure limitations set out in M.S.A. 211.06.

(2) **Campaign expenditures defined.** Campaign expenditures are amounts which were personally paid by the taxpayer during the taxable year to promote his election to a specific public office, provided:

(A) such amounts were paid for "legal expenses" as set forth in M.S.A. 211.02, and

(B) the obligations to pay such amounts were incurred by the taxpayer during the period commencing with the first day on which the filing was permitted for the public office for which the taxpayer was a candidate and ending with the day of the election which finally determined who will hold that public office.

(3) **Computation of amount deductible.** Subject to the limitations in the paragraph below, a candidate may deduct campaign expenditures which were personally paid by him and not subsequently reimbursed. The term "personally paid by a candidate" does not include campaign expenditures paid by the candidate out of funds contributed to him for use in his political campaign.

The maximum deductions allowable for a candidate are those set forth in M.S.A. 211.06.

If the candidate is reimbursed for campaign expenditures in a subsequent year, the reimbursement must be included in gross income in such subsequent year to the extent the deduction for campaign expenditures resulted in a tax benefit.

(4) **Violation of Corrupt Practice Act.** No deduction is permitted if the taxpayer failed to comply with the expenditure limitation set forth in M.S.A. 211.06.

(5) **Information to be submitted.** The following information must be included in the return of a taxpayer claiming a deduction for political campaign expenditures:

(A) General information.

(i) Office for which the taxpayer was a candidate, and the annual salary of such office.

(ii) Date on which the taxpayer became a candidate.

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(iii) Date on which filing opened for the public office sought by the taxpayer.

(iv) Date of the election which finally determined which candidate was to hold the public office sought by the taxpayer.

(B) **Schedules.**

(i) Schedule of campaign expenditures personally paid by the taxpayer. For each expenditure the following must be stated: (a) amount paid, (b) date of payment, (c) to whom paid, (d) purpose of expenditure.

(ii) Schedule of campaign contributions and reimbursements received by the taxpayer as an individual. The amounts received and the date on which they were received must be stated.

2009 (3)-1 INTEREST.

Interest paid or accrued within the taxable year on indebtedness is deductible with the following exceptions:

(1) Interest on indebtedness incurred or continued to purchase or carry obligations or securities, the income from which is excludible from gross income under M.S.A. 290.08. (However, interest paid by corporations taxable under M.S.A. 290.02 to purchase or carry obligations referred to in M.S.A. 290.08 is deductible.)

(2) Interest on indebtedness incurred or continued in connection with purchasing or carrying a single premium life insurance, annuity, or endowment contract (see M.S.A. 290.09, Subd. 3 (b) for the definition of such contracts).

Interest incurred on loans made by a taxpayer to finance the purchase of a home is deductible.

Interest paid to the State or Federal Government because of delinquent or additional income tax is deductible from gross income.

Interest computed on capital or surplus invested in the business which does not represent an expense on an interest bearing obligation is not an allowable deduction.

Interest on preferred or common stock, which is in reality a dividend thereon, cannot be deducted.

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2009 (4) TAXES.

Taxes paid or accrued within the taxable year are deductible, except:

(a) Minnesota state income and franchise taxes and Minnesota cigarette and tobacco products taxes.

(b) Improvement taxes.

(c) Inheritance, estate and gift taxes except as provided in M.S.A. 290.077, Subd. 4.

(d) Real property taxes paid by other than the owner.

Caution should be used in ascertaining the extent to which taxes are deductible. See M.S.A. 290.09, 290.10, 290.18 and 290.19.

Income taxes, including Federal victory taxes, deductible hereunder, are deductible only in the taxable year in which paid or withheld and then only to the extent provided by M.S.A. 290.18. Taxpayers keeping books on an accrual basis cannot accrue income taxes of any kind and use such accruals as deductions. In the case where income or victory taxes withheld are in

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excess of the amount of tax actually due, the excess shall be considered as taxable income in the year in which received to the extent the deduction for such Federal taxes resulted in a tax benefit.

Refunds of Minnesota income taxes which are included in the computation of Federal adjusted gross income shall be deductible in arriving at taxable net income.

For all taxable years beginning on or after January 1, 1943, gift taxes are not deductible from gross income.

Taxes on Minnesota real estate are due and payable on the first Monday of the year following assessment and are deductible accordingly. Taxes paid, except improvement taxes, on a home situated in Minnesota are deductible in their entirety. Taxes on Minnesota unimproved property, such as vacant lots, are deductible in the year when paid or accrued, dependent on the accounting method employed. Taxes on real estate located without this State where the income from such property is not includible in gross income assignable to Minnesota are not deductible. (See M.S.A. 290.18 (2).)

Delinquent taxes paid by the mortgagee prior or subsequent to foreclosure of the mortgage are not deductible, but must be capitalized.

So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare.

Federal excise taxes, such as cigarette taxes, liquor taxes, taxes on the purchase of automobiles, cosmetics, jewelry, furs or any other indirect taxes are not deductible by the consumer. Dealers or manufacturers, however, may deduct such taxes paid to the Federal government, if levied against them, to the extent provided in M.S.A. 290.18. Dealers or manufacturers may deduct these taxes if paid to the State of Minnesota, and if levied against them, in their entirety. Taxes paid to the Federal government under the Retailers' Excise Tax Act, Chapter 19 of the 1941 Internal Revenue Code relating to the sale of jewelry, furs and toilet preparations, may be deducted by the retailer to the extent provided in M.S.A. 290.18; such taxes are not deductible by the consumer.

Amusement taxes are deductible by the consumer if the taxing act imposes the burden to pay the tax directly upon the

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consumer, providing the taxpayer maintains a sufficiently accurate record or memorandum from which information may be obtained to substantiate the deduction. Auto license fees paid to the State of Minnesota are deductible in their entirety. Minnesota gasoline taxes are deductible in their entirety. Federal gasoline taxes are not deductible by the consumer. Postage is not a tax.

Social security and Minnesota unemployment compensation contributions are deductible by the employer. Such items must be reported as taxes paid in the income tax return and they must not be deducted as part of the payroll under salaries paid. Social security contributions made by the employee are not deductible from the gross income of such employee after January 1, 1941.

In the case of corporate bonds or obligations containing a tax-free covenant, the corporation paying a state or federal tax for someone else without reimbursement, such payment may be deducted by the corporation as interest paid on indebtedness. The amount of the tax so withheld need not be included in gross income of the bondholder, but in such event neither can it be deducted from his gross income. If a corporation pays taxes which are imposed upon a shareholder's interest therein without reimbursement from the shareholder, such taxes are deductible by the corporation and not by the shareholder.

A tenant-stockholder may claim a portion of the real estate taxes paid or accrued to the cooperative apartment corporation by the tenant-stockholder within the taxable year on the apartment building and the land on which it is situated, in the proportion which the stock of the corporation owned by the tenant-stockholder is to the total outstanding stock of the corporation, including that held by the corporation. However, in order to be entitled to this deduction, the stock of the tenant-stockholder must be fully paid up in an amount bearing reasonable relationship to the portion of the value of the corporation's equity in the building and land on which it is situated which is attributable to the apartment such individual is entitled to occupy.

2009 (5)-1 LOSSES

(a) Allowance Of Deduction In General. (1) Losses sustained which are not compensated for by insurance or otherwise are deductible under M.S.A. 290.09, Subd. 5 (a) if deduction of such losses is not prohibited or limited by any other provisions of M.S.A. Chapter 290. See, for example, M.S.A. 290.09, Subd. 5 (c) relating to individuals; M.S.A. 290.09, Subd. 5 (g) and M.S.A. 290.16, Subd. 5 relating to capital losses; M.S.A. 290.09, Subd. 5 (d), relating to wagering losses; M.S.A. 290.10 (6) relating to losses from sales or exchanges of property between related taxpayers, and M.S.A. 290.13 relating to exchanges of property where no gain or loss is recognized.

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(2) In general, losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable year for which allowed. Substance and not mere form will govern in determining the amount of losses actually sustained. See M.S.A. 290.12, Subd. 2.

(b) Voluntary Removal Of Buildings. Subject to the provisions of Reg. 2009 (15) (a)-8, an abnormal retirement loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements is deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal. It will be presumed that the value of the real estate, exclusive of old improvements, is equal to the purchase price of the land and building plus the cost of removing the useless building.

(c) Loss Of Useful Value. (1) When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis, (adjusted to the extent provided in M.S.A. 290.12, Subd. 2 or as otherwise specifically provided for under applicable provisions of Minnesota income tax laws) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. The limitations provided in M.S.A. 290.16, Subd. 5 and 6, with respect to the sale or exchange of capital assets have no application to losses due to the discarding of capital assets.

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(2) The method of computing the allowable deduction resulting from a casualty loss to business and nonbusiness property is provided for in the regulations under 2009 (5)-3 (c).

(d) Shrinkage in Value of Stocks. A person possessing stock of a corporation cannot deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined under M.S.A. 290.14 and 290.15 and adjusted to the extent provided in M.S.A. 290.12, Subd. 2 or as otherwise specifically provided for under applicable provisions of Minnesota Income Tax Act is deductible by the owner for the taxable year in which the stock showing is made of its worthlessness. See 2009 (5)-7. Federal or State authorities, incident to the regulation of banks and certain other corporations, may require that stock be charged off as worthless or written down to a nominal value. If, in any case, the basis of the requirement is the worthlessness of the stock, such charging off or writing down will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off or writing down is due to market fluctuations, or if no reasonable attempt has been made to determine worthlessness, no deduction for income tax purposes of the amount so charged off or written down can be allowed. For limitations on deductions for losses from sales or exchanges of capital assets generally, including stocks and bonds, see M.S.A. 290.16, Subd. 5 and 6.

(e) Losses In Farming. Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing taxable income. A taxpayer engaged in raising and selling stock, such as cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that were raised on the farm, except as such loss is reflected in an inventory if used. If livestock has been purchased for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such livestock, less any depreciation allowable as a deduction in respect of such perished livestock, may be deducted as a loss if the loss is not compensated for by insurance or otherwise. The actual cost of other property (with proper adjustment for depreciation) which is destroyed by order of the authorities of a State or of the United States, may in like manner be claimed as a loss. If reimbursement in whole or in part is made by a State or the United States on account of stock killed or

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other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for livestock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of livestock or products on hand at the close of the year. If a taxpayer owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. As to losses claimed as deductions for estate tax purposes, see Reg. 2009 Subd. 2 (5)-3 (a) (1).

2009 (5)-2 AMOUNT OF DEDUCTIONS IN GENERAL

In ascertaining the amount of the deduction for a loss allowed under M.S.A. 290.09, Subd. 5 (a), the amount of the loss realized and recognized is determined under M.S.A. 290.12, by reference to the adjusted basis provided in M.S.A. 290.14 and 290.15 for determining the loss from the sale or other disposition of property. Adjustments to basis shall be made in accordance with M.S.A. 290.12, Subd. 2. For example, proper adjustment under M.S.A. 290.16, Subd. 2 must be made for any expenditure, receipt, loss, or other item properly chargeable to capital account and for depreciation, obsolescence, amortization, and depletion.

2009 (5)-3 WAGERING LOSSES.

(a) No deduction shall be allowed for losses from wagering transactions except to the extent of the gains during the taxable year from such transactions. In the case of a husband and wife making a joint return, the combined losses of the spouses as a result of wagering transactions shall be allowed to the extent of the combined gains of the spouses from such tranactions during the taxable year.

(b) In the case of a taxpayer who is not engaged in the trade or business of gambling, losses from wagering transactions are not deductible from adjusted gross income in determining taxable income where the taxpayer has elected under M.S.A. 290.09, Subd. 15 to use the standard deduction.

(c) The application of paragraph (b) of this section may be illustrated by the following example:

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Example. G, an individual taxpayer not engaged in the trade or business of gambling, realized wagering gains of $300 in 1955 and sustained wagering losses of $375. G is required, under the provisions of M.S.A. 290.01, Subd. 20 to include the $300 wagering gains in his gross income. If G itemizes his deductions on his income tax return, a deduction for wagering losses may be taken to the extent of $300, the amount of wagering gains included in gross income. If G elects under M.S.A. 290.09, Subd. 15 to use the standard deduction, no part of the $375 wagering losses is deductible.

2009 (5)-5 THEFT LOSSES

(a) For purposes of M.S.A. 290.09, Subd. 5 (A), any loss arising from theft (including embezzlement, larceny, etc.) shall be treated as sustained during the taxable year in which the taxpayer discovers such loss, and is deductible only in that year.

2009 (5)-7 WORTHLESS SECURITIES

(a) In General. Any loss sustained by virtue of a security becoming worthless during the taxable year is, under M.S.A. 290.09, Subd. 5 (g), made subject to the limitations provided in M.S.A. 290.16, Subd. 5 and 6, with respect to sales or exchanges, provided the security is a "capital asset" as that term is defined in M.S.A. 290.16, Subd. 3. For the purposes of computing the taxable income of any taxpayer, such loss is to be considered as being sustained from the sale or exchange of the security on the last day of the taxable year, irrespective of when during the taxable year such security actually became worthless. No deduction shall be allowed on account of the worthlessness of any security, as defined in M.S.A. 290.09, Subd. 5 (g) (2) and paragraph (b) of this section, which is recoverable only in part.

(b) Definition Of Security. As used in M.S.A. 290.09, Subd. 5 (g) and this section, the term "security" means a share of stock in a domestic or foreign corporation; a right to subscribe for or to receive such a share; or a bond, debenture, note, or certificate, or other evidence of indebtedness to pay a fixed or determinable sum of money, which has been issued at any time by a domestic or foreign corporation (including those issued by any government or political subdivision thereof), in registered form or with interest coupons.

(c) Loss On Securities Of Affiliate-(1) In General. If a taxpayer is a domestic corporation and is affiliated, within the provisions of M.S.A. 290.09, Subd. 5 (g) (3) and subparagraph (2) of this paragraph, with another corporation, a security in such affiliated corporation owned by the taxpayer shall not be deemed to be a "capital asset" for the purpose of determining the loss under M.S.A. 290.09, Subd. 5 (g) from the worthlessness of such security. No deduction shall be allowed to the taxpayer with respect to any security which is recoverable only in part.

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(2) Affiliated Corporation Defined. For the purpose of M.S.A. 290.09, Subd. 5 (g), a corporation shall be deemed to be affiliated with the taxpayer only if all the following factors are present:

(i) The taxpayer is a domestic corporation of the United States;

(ii) The taxpayer owns directly at least 95 percent of each class of the stock of such corporations; and

(iii) More than 90 percent of the aggregate of the gross receipts of such corporation for all the taxable years during which it has been in existence has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the corporation in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities. For the purposes of M.S.A. 290.09, Subd. 5 (3) (B), gross receipts is the total amount of receipts before reduction of cost of goods sold. In computing gross receipts for the purposes of M.S.A. 290.09, Subd. 5 (g) (3) (B), gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom.

(3) Example. The application of paragraph (c) may be illustrated by the following example:

Example. Corporation P, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 100 percent of each class of the stock of Corporation S, and, in addition, 4 percent of the common stock (the only class of stock) of Corporation R which it acquired in 1948. Corporation S, a domestic manufacturing corporation which makes its income tax returns on the calendar year basis, owns 96 percent of the common stock of Corporation R which it acquired in 1952. It is established that the stock of Corporation R which has from its inception derived all its gross receipts from manufacturing operations, became worthless during 1956. Since Corporation C does not own directly 95 percent of the stock of Corporation R, and thus for purposes of M.S.A. 290.09, Subd. 5 (g) (3) be considered to be a loss from the sale or exchange of a capital asset. Since such stock was held for more than six months, such loss shall be considered a long-term capital loss as defined in M.S.A. 290.16, Subd. 3 (Since Corporation R is deemed to be affiliated with Corporation S for the purposes of M.S.A. 290.09 (g) (3) and this paragraph, the stock of Corporation R is not a capital asset in the hands of Corporation S for the purposes of M.S.A. 290.09, Subd. 5 (g). Consequently, the loss upon such stock may, under the provisions of M.S.A. 290.09, Subd. 5 (g) (1) and paragraph (a) of this section, may be treated as a capital loss, the taxpayer may not convert such loss into an ordinary loss under this

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paragraph by the acquisition of additional securities in the affiliated corporation solely for the purpose of bringing the holdings of the taxpayer up to the minimum stock ownership requirement provided in M.S.A. 290.09, Subd. 5 (g) (3).

2009(5)-8 DISASTER LOSSES.

M.S.A. 290.09, Subdivision 5(h) incorporates the provisions of Section 165(h) of the Internal Revenue Code of 1954 dealing with disaster losses. Any taxpayer desiring to make an election under the aforesaid provision of Section 290.09, where such loss occurs in the year 1966 or any subsequent year, shall evidence such election by attaching a statement to the return in which such loss is claimed stating that the election has also been exercised for federal purposes.

2009 (6)-1 BAD DEBTS

(a) Allowance Of Deduction. M.S.A. 290.09, Subd. 6 provides that, in computing taxable income under M.S.A. 290.18, a deduction shall be allowed in respect to bad debts owed to the taxpayer. For this purpose, bad debts shall, subject to the provisions of M.S.A. 290.09, Subd. 6 and the regulations thereunder, be taken into account either as—

(1) A deduction in respect of debts which become worthless in whole or in part; or as

(2) A deduction for a reasonable addition to a reserve for bad debts.

(b) Manner Of Selecting Method. (1) A taxpayer filing a return of income for the first taxable year for which he is

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entitled to a bad debt deduction may select either of the two methods prescribed by paragraph (a) of this section for treating bad debts, but such selection is subject to the approval of the Commissioner upon examination of the return. If the method so selected is approved, it shall be used in returns for all subsequent taxable years unless the Commissioner grants permission to use the other method. A statement of facts substantiating any deduction claimed under M.S.A. 290.09, Subd. 6 on account of bad debts shall accompany each return of income.

(2) Taxpayers who have properly selected one of the two methods for treating bad debts under provisions of prior law corresponding to M.S.A. 290.09, Subd. 6 shall continue to use that method for all subsequent taxable years unless the Commissioner grants permission to use the other method.

(3) For taxable years beginning before December 31, 1958, application for permission to change the method of treating bad debts shall be made at least 30 days before the close of the taxable year for which the change is effective.

(c) Bona Fide Debt Required. Only a bona fide debt qualifies for purposes of M.S.A. 290.09, Subd. 6. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A gift or contribution to capital shall not be considered a debt for purposes of M.S.A. 290.09, Subd. 6. The fact that a bad debt is not due at the time of deduction shall not of itself prevent its allowance under M.S.A. 290.09, Subd. 6.

(d) Amount Deductible—(1) General Rule. Except in the case of a deduction for a reasonable addition to a reserve for bad debts, the basis for determining the amount of deduction under M.S.A. 290.09, Subd. 6 in respect of a bad debt shall be the same as the adjusted basis prescribed by M.S.A. 290.14 and 290.15 for determining the loss from the sale or other disposition of property.

(2) Specific Cases. Subject to any provision of M.S.A. 290.09, Subd. 6 and the regulations thereunder which provides to the contrary, the following amounts are deductible as bad debts:

(i) Notes Or Accounts Receivable. (a) If, in computing taxable income, a taxpayer values his notes or accounts receivable at their fair market value when received, the amount deductible as a bad debt under M.S.A. 290.09, Subd. 6 in respect of such receivables shall be limited to such fair market value even though it is less than their face value.

(b) A purchaser of accounts receivable which become worthless during the taxable year shall be entitled under M.S.A. 290.09, Subd. 6 to a deduction which is based upon the price he paid for such receivables but not upon their face value.

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(ii) Bankruptcy Claim. Only the difference between the amount received in distribution of the assets of a bankrupt and the amount of the claim may be deducted under M.S.A. 290.09, Subd. 6 as a bad debt.

(iii) Claim Against Decedent's Estate. The excess of the amount of the claim over the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate may be considered a worthless debt under M.S.A. 290.09, Subd. 6.

(e) Prior Inclusion In Income Required. Worthless debts arising from unpaid wages, salaries, fees, rents, and similar items of taxable income shall not be allowed as a deduction under M.S.A. 290.09, Subd. 6 unless the income such items represent has been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year.

(f) Recovery of Bad Debts. Any amount attributable to the recovery during the taxable year of a bad debt, or of a part of a bad debt, which was allowed as a deduction from gross income in a prior taxable year shall be included in gross income for the taxable year of recovery, except to the extent that the recovery is excluded from gross income under the provisions of M.S.A. 290.071, Subd. 5, relating to the recovery of certain items previously deducted or credited. This paragraph shall not apply, however, to a bad debt which was previously charged against a reserve by a taxpayer on the reserve method of treating bad debts.

(g) Worthless Securities. (1) M.S.A. 290.09, Subd. 6 and the regulations thereunder do not apply to a debt which is evidenced by a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form. See, M.S.A. 290.09, Subd. 6 (e). For provisions allowing the deduction of a loss resulting from the worthlessness of such a debt, see Reg. 2009 (5)-7.

(2) The provisions of subparagraph (1) of this paragraph do not apply to any loss sustained by a bank and resulting from the worthlessness of a security described in M.S.A. 290.09, Subd. 5 (g) (2) (C).

2009 (6)-2 EVIDENCE OF WORTHLESSNESS.

(a) General Rule. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor.

(b) Legal Action Not Required. Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability

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not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of a debt for purposes of the deduction under M.S.A. 290.09, Subd. 6.

(c) Bankruptcy — (1) General Rule. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt.

(2) Year Of Deduction. In bankruptcy cases a debt may become worthless before settlement in some instances; and in others, only when a settlement in bankruptcy has been reached. In either case, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, thereby confirming the conclusion that the debt is worthless, shall not authorize the shifting of the deduction under M.S.A. 290.09, Subd. 6 to such later year.

(d) Banks And Other Regulated Corporations. (1) Worthlessness Presumed In Year Of Charge-off. If a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or in part in obedience to the specific orders of such supervisory authorities, then the debt shall, to the extent charged off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during such taxable year. But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.

(2) Evidence Of Worthlessness In Later Taxable Year. If such a bank or other corporation does not claim a deduction for such a totally or partially worthless debt in its return for the taxable year in which the charge-off takes place, but claims the deduction for a later taxable year, then the charge-off in the prior taxable year shall be deemed to have been involuntary and the deduction under M.S.A. 290.09, Subd. 6 shall be allowed for the taxable year for which claimed, provided that the taxpayer produces sufficient evidence to show that—

(i) The debt became wholly worthless in the later taxable year, or became recoverable only in part subsequent to the taxable year of the involuntary charge-off, as the case may be; and,

(ii) To the extent that the deduction claimed in the later taxable year for a debt partially worthless was not involuntarily charged off in prior taxable years, it was charged off in the later taxable year.

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2009 (6)-3 PARTIAL OR TOTAL WORTHLESSNESS.

(a) Partial Worthlessness—(1) Applicable To Specific Debts Only. A deduction under M.S.A. 290.09, Subd. 6 (a) (2) on account of partially worthless debts shall be allowed with respect to specific debts only.

(2) Charge-off Required. (i) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless shall be allowed as a deduction under M.S.A. 290.09, Subd. 6 (a) (2) but only to the extent charged off during the taxable year.

(ii) If a taxpayer claims a deduction for a part of a debt for the taxable year within which that part of the debt is charged off and the deduction is disallowed for that taxable year, then, in a case where the debt becomes partially worthless after the close of that taxable year, a deduction under M.S.A. 290.09, Subd. 6 (a) (2) shall be allowed for a subsequent taxable year but not in excess of the amount charged off in the prior taxable year plus any amount in the prior taxable year shall, if consistently maintained as such, be sufficient to that extent to meet the charge-off requirement of M.S.A. 290.09, Subd. 6 (a) (2) with respect to the subsequent taxable year.

(iii) Before a taxpayer may deduct a debt in part, he must be able to demonstrate to the satisfaction of the Commissioner the amount thereof which is worthless and the part thereof which has been charged off.

(b) Total Worthlessness. If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction from gross income for any prior taxable year shall be allowed as a deduction for the current taxable year.

2009 (6)-4 RESERVE FOR BAD DEBTS.

(a) Allowance Of Deduction. A taxpayer who has established the reserve method of treating bad debts and has maintained proper reserve accounts for bad debts or who, in accordance with paragraph (b) of 2009 (6)-1, adopts the reserve method of treating bad debts may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of deducting specific bad debt items.

(b) Reasonableness Of Addition To Reserve — (1) Relevant Factors. What constitutes a reasonable addition to a reserve for bad debts shall be determined in the light of the facts existing at the close of the taxable year of the proposed addition. The reasonableness of the addition will vary as between classes of business and the conditions of business prosperity. It will depend primarily upon the total amount of debts outstanding as of

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the close of the taxable year, including those arising currently as well as those arising in prior taxable years, and the total amount of the existing reserve.

(2) Correction Of Errors In Prior Estimates. In the event that subsequent realizations upon outstanding debts prove to be more or less than estimated at the time of the creation of the existing reserve, the amount of the excess or inadequacy in the existing reserve shall be reflected in the determination of the reasonable addition necessary in the current taxable year.

(c) Statement Required. A taxpayer using the reserve method shall file with his return a statement showing—

(1) The volume of his charge sales or other business transactions for the taxable year and the percentage of the reserve to such amount;

(2) The total amount of notes and accounts receivable at the beginning and close of the taxable year;

(3) The amount of the debts which have become wholly or partially worthless and have been charged against the reserve account; and

(4) The computation of the addition to the reserve for bad debts.

(d) **For special rules with respect to the addition to the reserve for bad debts of banks, savings, building and loan associations and mutual savings and cooperative banks,** see M.S.A. 290.09, **Subd. 6 (c).**

2009 (6)-5 NONBUSINESS DEBTS.

(a) Allowance of Deduction as Capital Loss. (1) The loss resulting from any nonbusiness debt's becoming partially or wholly worthless within the taxable year shall not be allowed as a deduction under either M.S.A. 290.09 (a) or M.S.A. 290.09, Subd. 6 (c) in determining the taxable income of a taxpayer other than a corporation. See M.S.A. 290.09, Subd. 6 (d) (1) (A).

(2) If, in the case of a taxpayer other than a corporation, a nonbusiness debt becomes wholly worthless within the taxable year, the loss resulting therefrom shall be treated as a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. Such a loss is subject to the limitations provided in M.S.A. 290.16, Subd. 5, relating to the limitation on capital losses, and M.S.A. 290.16, Subd. 6, relating to the capital loss carryover, and in the regulations under those sections. A loss on a nonbusiness debt shall be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a nonbusiness debt which is recoverable in part during the taxable year.

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(b) Nonbusiness Debt Defined. For the purpose of M.S.A. 290.09, Subd. 6 and this section, a nonbusiness debt is any debt other than—

(1) A debt which is created, or acquired, in the course of a trade or business of the taxpayer, determined without regard to the relationship of the debt to a trade or business of the taxpayer at the time when the debt becomes worthless; or

(2) A debt, the loss from the worthlessness of which is incurred in the taxpayer's trade or business,

The question whether a debt is a nonbusiness debt is a question of facts in each particular case. The determination of whether the loss on a debt's becoming worthless has been incurred in a trade or business of the taxpayer shall, for this purpose, be made in substantially the same manner for determining whether a loss has been incurred in a trade or business for purposes of M.S.A. 290.09, Subd. 5 (c) (1). For purposes of subparagraph (2) of this paragraph, the character of the debt is to be determined by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt comes within the exception provided by that subparagraph. The use to which the borrowed funds are put by the debtor is of no consequence in making a determination under this paragraph. For purposes of M.S.A. 290.09, Subd. 6 and this section, a nonbusiness debt does not include a debt described in M.S.A. 290.09, Subd. 5 (g) (2) (C). See Reg. 2009 (5)-5 relating to losses on worthless securities.

(c) Guaranty Of Corporate Obligations. For provisions treating a loss sustained by a guarantor of the obligations of a corporation as a loss resulting from the worthlessness of a nonbusiness debt, see paragraph (b) of Reg. 2009 (6)-8.

(d) Examples. The application of this section may be illustrated by the following examples involving a case where A, an individual who is engaged in the grocery business and who makes his return on the basis of the calendar year, extends credit to B in 1959 on an open account.

Example (1). In 1960 A sells the business but retains the claim against B. The claim becomes worthless in A's hands in 1961. A's loss is not controlled by the nonbusiness debt provisions, since the original consideration has been advanced by A in his trade or business.

Example (2). In 1959 A sells the business to C but sells the claim against B to the taxpayer, D. The claim becomes worthless in D's hands in 1960. During 1959 and 1960, D is not engaged in any trade or business. D's loss is controlled by the nonbusiness

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debt provisions even though the original consideration has been advanced by A in his trade or business, since the debt has not been created or acquired in connection with a trade or business of D and since in 1960 D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such claim is a proximate result.

Example (3). In 1959 A dies, leaving the business, including the accounts receivable to his son, C, the taxpayer. The claim against B becomes worthless in C's hands in 1960. C's loss is not controlled by the nonbusiness debt provisions. While C does not advance any consideration for the claim, or create or acquire it in connection with his trade or business, the loss is sustained as a proximate incident to the conduct of the trade or business in which he is engaged at the time the debt becomes worthless.

Example (4). In 1959 A dies, leaving the business to his son, C, but leaving the claim against B to his son, D, the taxpayer. The claim against B becomes worthless in D's hands in 1960. During 1959 and 1960, D is not engaged in any trade or business. D's loss is controlled by the nonbusiness debt provisions even though the original consideration has been advanced by A in his trade or business, since the debt has not been created or acquired in connection with a trade or business of D and since in 1960 D is not engaged in a trade or business incident to the conduct of which a loss from the worthlessness of such claim is a proximate result.

Example (5). In 1959 A dies; and, while his executor, C, is carrying on the business the claim against B becomes worthless in 1960. The loss sustained by A's estate is not controlled by the nonbusiness debt provisions. While C does not advance any consideration for the claim on behalf of the estate, or create or acquire it in connection with a trade or business in which the estate is engaged, the loss is sustained as a proximate incident to the conduct of the trade or business in which the estate is engaged at the time the debt becomes worthless.

Example (6). In 1959 A, in liquidating the business, attempts to collect the claim against B but finds that it has become worthless. A's loss is not controlled by the nonbusiness debt provisions, since the original consideration has been advanced by A in his trade or business and since a loss incurred in liquidating a trade or business is a proximate incident to the conduct thereof.

2009 (6)-6 SALE OF MORTGAGED OR PLEDGED PROPERTY.

(a) Deficiency Deductible As Bad Debt. (1) Principal amount. If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of

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the debt, and the portion of the indebtedness remaining unsatisfied after the sale is wholly or partially uncollectible, the mortgagee or pledgee may deduct such amount under M.S.A. 290.09, Subd. 6 (a) (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it becomes wholly worthless or is charged off as partially worthless. See Reg. 2009 (6)-3.

(2) Accrued Interest. Accrued interest may be included as part of the deduction allowable under this paragraph, but only if it has previously been returned as income.

(b) Realization Of Gain Or Loss—(1) Determination Of Amount. If, in the case of a sale described in paragraph (a) of this section, the creditor buys in the mortgaged or pledged property, loss or gain is also realized, measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by the creditor) and the fair market value of the property.

(2) Fair Market Value Defined. The fair market value of the property for this purpose shall, in the absence of clear and convincing proof to the contrary, be presumed to be the amount for which it is bid in by the taxpayer.

(c) Basis Of Property Purchased. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss upon the subsequent sale is the fair market value of the property at the date of its acquisition by the creditor.

2009 (6)-7 WORTHLESS BONDS ISSUED BY AN INDIVIDUAL.

(a) Allowance Of Deduction. A bond or other similar obligation issued by an individual, if it becomes worthless in whole or in part, is subject to the bad debt provisions of M.S.A. 290.09, Subd. 6. The loss from the worthlessness of any such bond or obligation is deductible in accordance with M.S.A. 290.09, Subd. 6 (a), unless such bond or obligation is a nonbusiness debt as defined in M.S.A. 290.09 (d) (2). If the bond or obligation is a nonbusiness debt, it is subject to M.S.A. 290.09, Subd. 6 (d) and Reg. 2009 (6)-5.

(b) Decline In Market Value. A taxpayer possessing debts evidenced by bonds or other similar obligations issued by an individual shall not be allowed any deduction under M.S.A. 290.09, Subd. 6 on account of mere market fluctuation in the value of such obligations.

(c) Worthless Bonds Issued By Corporations. For provisions allowing the deduction under M.S.A. 290.09, Subd. 5 (a) of the

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loss sustained upon the worthlessness of any bond or similar obligation issued by a corporation or a government, see Reg. 2009 (5)-7.

(d) Application To Inventories. This section does not apply to any loss upon the worthlessness of any bond or similar obligation reflected in inventories required to be taken by a dealer in securities under M.S.A. 290.11.

2009 (6)-8 LOSSES OF GUARANTORS, ENDORSERS, AND INDEMNITORS.

(a) Noncorporate Obligations—(1) Deductible As Bad Debt. A payment during the taxable year by a taxpayer other than a corporation in discharge of part or all of his obligation as a guarantor, endorser, or indemnitor of an obligation issued by a person other than a corporation shall, for purposes of M.S.A. 290.09, Subd. 6 and the regulations thereunder, be treated as a debt's becoming worthless within the taxable year, if—

(i) The proceeds of the obligation so issued have been used in the trade or business of the borrower, and

(ii) The borrower's obligation to the person to whom the taxpayer's payment is made is worthless at the time of payment except for the existence of the guaranty, endorsement, or indemnity whether or not such obligation has in fact become worthless within the taxable year in which payment is made.

(2) Nonbusiness Debt Rule Not Applicable. If a payment is treated as a loss in accordance with the provisions of subparagraph (1) of this paragraph, M.S.A. 290.09, Subd. 6 (d), relating to the special rule for losses sustained on the worthlessness of a nonbusiness debt, shall not apply. Accordingly, in each instance the loss shall be deducted under M.S.A. 290.09, Subd. 6 (a) (1) as a wholly worthless debt even though there has been a discharge of only a part of the taxpayer's obligation. Thus, if the taxpayer makes a payment during the taxable year in discharge of only part of his obligation as a guarantor, endorser, or indemnitor, he may treat such payment under M.S.A. 290.09, Subd. 6 (a) (1) as a debt's becoming wholly worthless within the taxable year, provided that he can establish that such part of the borrower's obligation to the person to whom the taxpayer's payment is made is worthless at the time of payment and the conditions of subparagraph (1) of this paragraph have otherwise been satisfied.

(3) Other Applicable Provisions. Other provisions of the internal revenue laws relating to bad debts, such as M.S.A. 290.071, Subd. 5, relating to the recovery of bad debts, shall be deemed to apply to any payment which, under the provisions of this paragraph, is treated as a bad debt. If the requirement of M.S.A. 290.09, Subd. 6 (f) are not met, any loss sustained by a guarantor,

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endorser, or indemnitor upon the worthlessness of the debtor's obligation shall be treated under the provisions of law applicable thereto. See, for example, paragraph (b) of this section.

(b) Corporate Obligations. The loss sustained during the taxable year by a taxpayer other than a corporation in discharge of all of his obligation of a guarantor of an obligation issued by a corporation shall be treated, in accordance with M.S.A. 290.09, Subd. 6 (d) and the regulations thereunder, as a loss sustained on the worthlessness of a nonbusiness debt if the debt created in the guarantor's favor as a result of the payment does not come within the exceptions prescribed by M.S.A. 290.09, Subd. 6 (d) (2) (A) or (B). See paragraph (a) (2) of Reg. 2009 (6)-5.

(c). Examples. The application of this section may be illustrated by the following examples:

Example (1) During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X bank, the proceeds of the obligation being used in B's business. B defaults on his obligation in 1960. A makes payment to the X Bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of B to the X Bank, being wholly worthless. For his taxable year 1961, A is entitled to a deduction under M.S.A. 290.09, Subd. 6 (a) (1) as a result of his payment during that year.

Example (2). During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X Bank, the proceeds of the obligation being used in B's business. In 1960, B pays a part of his obligation to the X Bank but defaults on the remaining part. In 1961, A makes payment to the X Bank, in discharge of part of his obligation as a guarantor, of the remaining unpaid part of B's obligation to the bank, such part of B's obligation then being worthless. For his taxable year 1961, A is entitled to a deduction under M.S.A. 290.09, Subd. 6 (a) (1) as a result of his payment of the remaining part of B's obligation.

Example (3). During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of B, an individual, to the X Bank, the proceeds of the obligation being used for B's personal use. B defaults on his obligation in 1960. A makes payment to the X Bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of B to X Bank being wholly worthless. A may not apply the benefit of M.S.A. 290.09, Subd. 6 (f) to his loss, since the proceeds of B's obligation have not been used in B's trade or business.

Example (4). During 1959, A, an individual who makes his return on the basis of the calendar year, guarantees payment of an obligation of Y Corporation to the X Bank, the proceeds of the obligation being used in X Corporation's business. Y Cor-

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poration defaults on its obligation in 1960. A makes payment to the X Bank during 1961 in discharge of his entire obligation as a guarantor, the obligation of Y Corporation to the X Bank being wholly worthless. At no time during 1959 or 1961 is A engaged in a trade or business. For the taxable year 1961, A is entitled to deduct a capital loss in accordance with the provisions of M.S.A. 290.09, Subd. 6 (d) and paragraph (a) (2) of Reg. 2009 (6)-5. He may not apply the benefit of M.S.A. 290.09, Subd. 6 (f) to his loss, since his payment is in discharge of an obligation issued by a corporation.

2009 (7) (A) (a)-1 DEPRECIATION IN GENERAL

(a) Reasonable Allowance. M.S.A. 290.09, Subd. 7 (A) (a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in M.S.A. 290.09, Subd. 7 (A) (f) and 2009, (7) (A) (f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

(b) Useful Life. For the purpose of M.S.A. 290.09, Subd. 7 (A) the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be rede-

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termined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see M.S.A. 290.09, Subd. 7 (A) (d) and 2009 (7) (A) (d)-1.

(c) Salvage. Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b) of this section, salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, 2009 (7) (A) (b)-2 (a) for the treatment of salvage under the declining balance method. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see 2009 (7) (A) (b)-1, 2009 (7) (A) (b)-2, and 2009 (7) (A) (b)-3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

2009 (7) (A) (a)-2 TANGIBLE PROPERTY

The depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to inventories or stock in trade, or to land apart from the improvements or physical development added to it. The allowance does

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not apply to natural resources which are subject to the allowance for depletion provided in M.S.A. 290.09, Subd. 8. No deduction for depreciation shall be allowed on automobiles or other vehicles used solely for pleasure, on a building used by the taxpayer solely as his residence, or on furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be depreciated.

2009 (7) (A) (a)-3 INTANGIBLES

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill. For rules with respect to organizational expenditures, see M.S.A. 290.09, Subd. 19 and the regulations thereunder.

2009 (7) (A) (a)-4 LEASED PROPERTY

Capital expenditures made by a lessee for the erection of buildings or the construction of other permanent improvements on leased property are recoverable through allowances for depreciation or amortization. If the useful life of such improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, the allowances shall take the form of depreciation under M.S.A. 290.09 Subd. 7 (A). See 2009 (7) (A) (b)-0, 2009 (7) (A) (b)-1, 2009 (7) (A) (b)-2, 2009 (7) (A) (b)-3, and 2009 (7) (A) (b)-4 for methods of computing such depreciation allowances. If, on the other hand, the estimated useful life of such property in the hands of the taxpayer, determined without regard to the terms of the lease would be longer than the remaining period of such lease, the allowances shall take the form of annual deductions from gross income in an amount equal to the unrecovered cost of such capital expenditures divided by the number of years remaining of the term of the lease. Such deductions shall be in lieu of allowance for depreciation. See M.S.A. 290.09, Subd. 2 and the regulations thereunder. Capital expenditures made by a lessor for the erection of buildings or other improvements shall if subject to depreciation allowances, be recovered by him over the estimated life of the improvements without regard to the period of the lease.

2009 (7) (A) (a)-5 APPORTIONMENT OF BASIS

In the case of the acquisition on or after January 1, 1933, of a combination of depreciable and nondepreciable property for a

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lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. In the case of property which is subject to both the allowance for depreciation and amortization, depreciation is allowable only with respect to the portion of the depreciable property which is not subject to the allowance for amortization and may be taken concurrently with the allowance for amortization. After the close of the amortization period or after amortization deductions have been discontinued with respect to any such property, the unrecovered cost or other basis of the depreciable portion of such property will be subject to depreciation. For adjustments to basis, see M.S.A. 290.12, Subd. 2, and other applicable provisions of law.

2009 (7) (A) (a)-6 DEPRECIATION IN SPECIAL CASES.

(a) Depreciation Of Patents Or Copyrights. The cost or other basis of a patent or copyright shall be depreciated over its remaining useful life. Its cost to the patentee includes the various Government fees, cost of drawings, models, attorneys' fees, and similar expenditures. For rules applicable to research and experimental expenditures, see M.S.A. 290.09, Subd. 18 and 290.12, Subd. 2 and the regulations thereunder. If a patent or copyright becomes valueless in any year before its expiration the unrecovered cost or other basis may be deducted in that year.

(b) Depreciation In Case Of Farmers. A reasonable allowance for depreciation may be claimed on farm buildings (except a dwelling occupied by the owner), farm machinery, and other physical property but not including land. Livestock acquired for work, breeding, or dairy purposes may be depreciated unless included in an inventory used to determine profits in accordance with M.S.A. 290.01, Subd. 20 and the regulations thereunder. Such depreciation should be determined with reference to the cost or other basis, salvage value, and the estimated useful life of the livestock. See also M.S.A. 290.09, Subd. 2 and the regulations thereunder relating to trade or business expenses, M.S.A. 290.09, Subd. 5 and the regulations thereunder relating to losses of farmers, and M.S.A. 290.09, Subd. 21 and the regulations thereunder relating to soil or water conservation expenditures.

2009 (7) (A) (a)-7 ACCOUNTING FOR DEPRECIABLE PROPERTY.

(a) Depreciable property may be accounted for by treating each individual item as an account, or by combining two or more assets in a single account. Assets may be grouped in an account in a variety of ways. For example, assets similar in kind with approximately the same useful lives may be grouped together.

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Such an account is commonly known as a group account. Another appropriated grouping might consist of assets segregated according to use without regard to useful life, for example, machinery and equipment, furniture and fixtures, or transportation equipment. Such an account is commonly known as a classified account. A broader grouping, where assets are included in the same account regardless of their character or useful lives, is commonly referred to as a composite account. Group, classified, or composite accounts may be further broken down on the basis of location, dates of acquisition, cost, character, use, etc.

(b) When group, classified, or composite accounts are used with average useful lives and a normal retirement occurs, the full cost or other basis of the asset retired unadjusted for depreciation or salvage, shall be removed from the asset account and shall be charged to the depreciation reserve. Amounts representing salvage ordinarily are credited to the depreciation reserve. Where an asset is disposed of for reasons other than normal retirement, the full cost or other basis of the asset shall be removed from the asset account, and the depreciation reserve shall be charged with the depreciation applicable to the retired asset. For rules with respect to losses on normal retirements, see 2009 (7) (A) (a)-8.

(c) A taxpayer may establish as many accounts for depreciable property as he desires. Depreciation allowances shall be computed separately for each account. Such depreciation preferably should be recorded in a depreciation reserve account; however, in appropriate cases it may be recorded directly in the asset account. Where depreciation reserves are maintained a separate reserve account shall be maintained for each asset account. The regular books of account or permanent auxiliary records shall show for each account the basis of the property, including adjustments necessary to conform to the requirements of M.S.A. 290.12, Subd. 2 and other provisions of law relating to adjustments to basis, and the depreciation allowance for tax purposes. In the event that reserves for book purposes do not correspond with reserves maintained for tax purposes, permanent auxiliary records shall be maintained with the regular books of accounts reconciling the differences in depreciation for tax and book purposes because of different methods of depreciation, basis, rates, salvage, or other factors. Depreciation schedules filed with the income tax return shall show the accumulated reserves computed in accordance with the allowances for income tax purposes.

(d) In classified or composite accounts, the average useful life and rate shall be redetermined whenever additions, retirements, or replacements substantially alter the relative proportion of types of assets in the accounts. See example (2) in 2009 (7) (A) (b)-1 (b) for method of determining the depreciation rate for a classified or composite account.

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2009 (7) (A) (a)-8 RETIREMENTS.

(a) Gains and Losses On Retirements. For the purposes of this section the term "retirement" means the permanent withdrawal of depreciable property from use in the trade or business or in the production of income. The withdrawal may be made in one of several ways. For example, the withdrawal may be made by selling or exchanging the asset, or by actual abandonment. In addition, the asset may be withdrawn from such productive use without disposition as, for example, by being placed in a supplies or scrap account. The tax consequences of a retirement depend upon the form of the transaction, the reason therefor, the timing of the retirement, the estimated useful life used in computing depreciation, and whether the asset is accounted for in a separate or multiple asset account. Upon the retirement of assets, the rules in this section apply in determining whether gain or loss will be recognized, the amount of such gain or loss, and the basis for determining gain or loss:

(1) Where an asset is retired by sale at arm's length, recognition of gain or loss will be subject to the provisions of M.S.A. 290.16, Subd. 9, and other applicable provisions of law.

(2) Where an asset is retired by exchange, the recognition of gain or loss will be subject to the provisions of M.S.A. 290.13 and 290.16, Subd. 9, and other applicable provisions of law.

(3) Where an asset is permanently retired from use in the trade or business or in the production of income but is not disposed of by the taxpayer or physically abandoned (as, for example, when the asset is transferred to a supplies or scrap account), gain will not be recognized. In such a case loss will be recognized measured by the excess of the adjusted basis of the asset at the time of retirement over the estimated salvage value or over the fair market value at the time of such retirement if greater, but only if—

(i) The retirement is an abnormal retirement, or

(ii) The retirement is a normal retirement from a single asset account (but see paragraph (d) of this section for special rule for item accounts), or

(iii) The retirement is a normal retirement from a multiple asset account in which the depreciation rate was based on the maximum expected life of the longest lived asset contained in the account.

(4) Where an asset is retired by actual physical abandonment (as, for example, in the case of a building condemned as unfit for further occupancy or other use), loss will be recognized measured by the amount of the adjusted basis of the asset abandoned at the time of such abandonment. In order to qualify for the recognition of loss from physical abandonment, the intent

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of the taxpayer must be irrevocably to discard the asset so that it will neither be used again by him nor retrieved by him for sale, exchange, or other disposition.

Experience with assets which have attained an exceptional or unusual age shall, with respect to similar assets, be disregarded in determining the maximum expected useful life of the longest lived asset in a multiple asset account. For example, if a manufacturer establishes a proper multiple asset account for 50 assets which are expected to have an average life of 30 years but which will remain useful to him for varying periods between 20 and 40 years, even though an occasional asset of this kind may last 60 years.

(b) Definition Of Normal And Abnormal Retirements. For the purpose of this section the determination of whether a retirement is normal or abnormal shall be made in the light of all the facts and circumstances. In general, a retirement shall be considered a normal retirement unless the taxpayer can show that the withdrawal of the asset was due to a cause not contemplated in setting the applicable depreciation rate. For example, a retirement is considered normal if made within the range of years taken into consideration in fixing the depreciation rate and if the asset has reached a condition at which, in the normal course of events, the taxpayer customarily retires similar assets from use in his business. On the other hand, a retirement may be abnormal if the asset is withdrawn at an earlier time or under other circumstances, as, for example, when the asset has been damaged by casualty or has lost its usefulness suddenly as the result of extraordinary obsolescence.

(c) Basis Of Assets Retired. The basis of an asset at the time of retirement for computing gain or loss shall be its adjusted basis for determining gain or loss upon a sale or other disposition as determined in accordance with the provisions of M.S.A. 290.12 and the following rules:

(1) In the case of a normal retirement of an asset from a multiple asset account where the depreciation rate is based on average expected useful life, the term "adjusted basis" means the salvage value estimated in determining the depreciation deduction in accordance with the provisions of 2009 (7) (A) (a)-1 (c),

(2) In the case of a normal retirement of an asset from a multiple asset account in which the depreciation rate was based on the maximum expected life of the longest lived asset in the account, the adjustment for depreciation allowed or allowable shall be made at the rate which would have been proper if the asset had been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) using a rate based upon the maximum expected useful life of that asset, and

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(3) In the case of an abnormal retirement from a multiple asset account the adjustment for depreciation allowed or allowable shall be made at the rate which would have been proper had the asset been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) and using a rate based upon either the average expected useful life or the maximum expected useful life of the asset, depending upon the method of determining the rate of depreciation used in connection with the multiple asset account.

(d) Special Rule For Item Accounts. (1) As indicated in paragraphs (a) (3) (ii) and (iii) of this section, a loss is recognized upon the normal retirement of an asset from a single asset account but a loss on the normal retirement of an asset in a multiple asset account is not allowable where the depreciation rate is based upon the average useful life of the assets in the account where a taxpayer with more than one depreciable asset chooses to set up a separate account for each such asset and the depreciation rate is based on the average useful life of such assets (so that he uses the same life for each account), the question arises whether his depreciation deductions in substance are the equivalent of those which would result from the use of multiple asset accounts and, therefore, he should be subject to the rules governing losses on retirements of assets from multiple asset accounts. Where a taxpayer has only a few depreciable assets which he chooses to account for in single asset accounts, particularly where such assets cover a relatively narrow range of lives, it cannot be said in the usual case that the allowance of losses on retirements from such accounts clearly will distort income. This results from the fact that where a taxpayer has only a few depreciable assets it is usually not possible clearly to determine that the depreciation rate is based upon the average useful life of such assets. Accordingly, it cannot be said that the taxpayer is in effect clearly operating with a multiple asset account using an average life rate so that losses should not be allowed on normal retirements. Therefore, losses normally will be allowed upon retirement of assets from single asset accounts where the taxpayer has only a few depreciable assets. On the other hand, when a taxpayer who has only a few depreciable assets chooses to account for them in single asset accounts, using for each account a depreciation rate based on the average useful life of such assets, and the assets cover a wide range of lives, the likelihood that income will be distorted is greater than where the group of assets covers a relatively narrow range of lives. In those cases where the allowance of losses would distort income, the rules with respect to the allowance of losses on normal retirement shall be applied to such assets in the same manner as though the assets had been accounted for in multiple asset accounts using a rate based upon average expected useful life.

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(2) Where a taxpayer has a large number of depreciable assets and depreciation is based on the average useful life of such assets, then, whether such assets are similar or dissimilar and regardless of whether they are accounted for in individual asset accounts the allowance of losses on the normal retirement of such assets would distort income. Such distortion would result from the fact that the use of average life (and, accordingly, average rate) assumes that while some assets normally will be retired before the expiration of the average life, others normally will be retired after the expiration of the average life. Accordingly, if instead of accounting for a large number of similar or dissimilar depreciable assets in multiple asset accounts, the taxpayer chooses to account separately for such assets, using a rate based upon the average life of such assets, the rules with respect to the allowances of losses on normal retirements will be applied to such assets in the same manner as though the assets were accounted for in multiple asset accounts using a rate based upon average expected useful life.

(3) Where a taxpayer who does not have a large number of depreciable assets (and who therefore is not subject to subparagraph (2) of this paragraph) chooses to set up a separate account for each such asset, and has sought to compute an average life for such assets on which to base his depreciation deductions (so that he uses the same life for each account), the allowance of losses on normal retirements from such accounts may in some situations substantially distort income. Such distortion would result from the fact that the use of average useful life (and, accordingly, average rate) assumes that while some assets normally will be retired before expiration of the average life, others normally will be retired after expiration of the average life. Accordingly, where a taxpayer chooses to account separately for such assets instead of accounting for them in multiple asset accounts, and the result is to substantially distort his income, the rules with respect to the allowance of losses on normal retirements shall be applied to such assets in the same manner as though the assets had been accounted for in multiple asset accounts using a rate based upon average expected useful life.

(4) Whenever a taxpayer is treated under this paragraph as though his assets were accounted for in a multiple asset account using an average life rate, and, therefore, he is denied a loss on retirements, the unrecovered cost less salvage of each asset which was accounted for separately may be amortized in accordance with the rule stated in paragraph (e) (1) (ii) of this section.

(e) Accounting Treatment Of Asset Retirements. (1) In the case of a normal retirement where under the foregoing rules no loss is recognized and where the asset is retired without disposition or abandonment, (i) if the asset was contained in a mul-

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tiple asset account, the full cost of such asset, reduced by estimated salvage, shall be charged to the depreciation reserve, or (ii) if the asset was accounted for separately, the unrecovered cost or other basis, less salvage, of the asset may be amortized through annual deductions from gross income in amounts equal to the unrecovered cost or other basis of such asset, divided by the average expected useful life (not the remaining useful life) applicable to the asset at the time of retirement. For example, if an asset is retired after six years of use and at the time of retirement depreciation was being claimed on the basis of an average expected useful life of ten years, the unrecovered cost or other basis less salvage would be amortized through equal annual deductions over a period of ten years from the time of retirement.

(2) Where multiple asset accounts are used and acquisitions and retirements are numerous, if a taxpayer, in order to avoid unnecessarily detailed accounting for individual retirements, consistently follows the practice of charging the reserve with the full cost or other basis of assets retired and of crediting it with all receipts from salvage, the practice may be continued so long as, in the opinion of the Commissioner, it clearly reflects income. Conversely, where the taxpayer customarily follows a practice of reporting all receipts from salvage as ordinary taxable income such practice may be continued so long as, in the opinion of the Commissioner, it clearly reflects income.

(f) Cross reference. For special rules in connection with the retirement of the last assets of a given year's acquisitions under the declining balance method, see example (2) in 2009 (7) (A) (b)-2 (b).

2009 (7) (A) (a)-9 OBSOLESCENCE

The depreciation allowance includes an allowance for normal obsolescence which should be taken into account to the extent that the expected useful life of property will be shortened by reason thereof. Obsolescence may render an asset economically useless to the taxpayer regardless of its physical condition. Obsolescence is attributable to many causes, including technological improvements and reasonably foreseeable economic changes. Among these causes are normal progress of the arts and sciences, supercession or inadequacy brought about by developments in the industry, products, methods, markets, sources of supply, and other like changes, and legislative or regulatory action. In any case in which the taxpayer shows that the estimated useful life previously used should be shortened by reason of obsolescence greater than had been assumed in computing such estimated useful life, a change to a new and shorter estimated useful life computed in accordance with such showing will be permitted. No such change will be permitted merely be-

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cause in the unsupported opinion of the taxpayer the property may become obsolete. For rules governing the allowance of a loss when the usefulness of an asset is suddenly terminated, see M.S.A. 290.09, Subd. 7 (A) (d) and 2009 (7) (A) (d)-1.

2009 (7) (A) (a)-10 WHEN DEPRECIATION DEDUCTION IS ALLOWABLE

(a) A taxpayer should deduct the proper depreciation allowance each year and may not increase his depreciation allowances in later years by reason of his failure to deduct any depreciation allowance or of his action in deducting an allowance plainly inadequate under the known facts in prior years. The inadequacy of the depreciation allowance for property in prior years shall be determined on the basis of the allowable method of depreciation used by the taxpayer for such property or under the straight line method of no allowance has ever been claimed for such property. The preceding sentence shall not be construed as precluding application of any method provided in M.S.A. 290.09, Subd. 7 (A) (b) if taxpayer's failure to claim any allowance for depreciation was due solely to erroneously treating as a deductible expense an item properly chargeable to capital account. For rules relating to adjustments to basis, see M.S.A. 290.12, Subd. 2 and the regulations thereunder.

(b) The period for depreciation of an asset shall begin when the asset is placed in service and shall end when the asset is retired from service. A proportionate part of one year's depreciation is allowable for that part of the first and last year during which the asset was in service. However, in the case of a multiple asset account, the amount of depreciation may be determined by using what is commonly described as an "averaging convention", that is, by using an assumed timing of additions and retirements. For example, it might be assumed that all additions and retirements to the asset account occur uniformly throughout the taxable year, in which case depreciation is computed on the average of the beginning and ending balances of the asset account for the taxable year. See example (3) under 2009 (7) (A) (b)-1 (b). Among still other averaging conventions which may be used is the one under which it is assumed that all additions and retirements during the first half of a given year were made on the first day of that year and that all additions and retirements during the second half of the year were made on the first day of the following year. Thus, a full year's depreciation would be taken on additions in the first half of the year and no depreciation would be taken on additions in the second half. Moreover, under this convention, no depreciation would be taken on retirements in the second half. An averaging convention, if used, must be consistently followed as to the account or accounts for which it is adopted, and must be applied to both additions and

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retirements. In any year in which an averaging convention substantially distorts the depreciation allowance for the taxable year, it may not be used.

2009 (7) (A) (b)-(o) METHODS OF COMPUTING DEPRECIATION.

(a) In General. Any reasonable and consistently applied method of computing depreciation may be used or continued in use under M.S.A. 290.09, Subd. 7 (A). Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made. It is the responsibility of the taxpayer to establish the reasonableness of the deduction for depreciation claimed. Generally, depreciation deductions so claimed will be changed only where there is a clear and convincing basis for a change.

(b) Certain Methods. Methods previously found adequate to produce a reasonable allowance under prior laws will, if used consistently by the taxpayer, continue to be acceptable under M.S.A. 290.06 (A) (a). Examples of such methods which continue to be acceptable are the straight line method, the declining balance method with the rate limited to 150 percent of the applicable straight line rate, and under appropriate circumstances, the unit of production method. The methods described in M.S.A. 290.09, Subd. 7 (A) (b) and 2009 (7) (A) (b)-1, 2009 (7) (A) (b)-2, 2009 (7) (A) (b)-3, and 4 shall be deemed to produce a reasonable allowance for depreciation except as limited under M.S.A. 290.09, Subd. 7 (A) (c) and 2009 (7) (A) (c)-1. See also 2009 (7) (A) (e)-1 for rules relating to change in method of computing depreciation.

(c) Application Of Methods. In the case of item accounts, any method which results in a reasonable allowance for depreciation may be selected for each item of property, but such method must thereafter be applied consistently to that particular item. In the case of group, classified, or composite accounts, any method may be selected for each account. Such method must be applied to that particular account consistently thereafter but need not necessarily be applied to acquisitions of similar property in the same or subsequent years, provided such acquisitions are set up in separate accounts. See, however, 2009 (7) (A) (e)-1 and M.S.A. 290.07, Subd. 2 and the regulations thereunder, for rules relating to changes in the method of computing depreciation, and 2009 (7) (A) (c)-1 for restriction on the use of certain methods. See also 2009 (7) (A) (a)-7 for definition of account.

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2009 (7) (A) (b)-1 STRAIGHT LINE METHOD.

(a) Application of Method. Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property. The allowance for depreciation for the taxable year is determined by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under M.S.A. 290.09, Subd. 7 (A) and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

(b) Illustrations. The straight line method is illustrated by the following examples:

Example (1). Under the straight line method items may be depreciated separately:

Year	Item	Cost or other basis less salvage	Useful life Years[1]	Depreciation allowable 1958	1959	1960
1958	Asset A.	$ 1,600	4	$200	$400	$400
	Asset B.	12,000	40	150	300	300

[1]In this example, it is assumed that the assets were placed in service on July 1, 1958.

Example (2). In group, classified, or composite accounting, a number of assets with the same or different useful lives may be combined into one account, and a single rate of depreciation, i.e., the group, classified, or composite rate used for the entire account. In the case of group accounts, i. e., accounts containing assets which are similar in kind and which have approximately the same estimated useful lives, the group rate is determined from the average of the useful lives of the assets. In the case of classified or composite accounts, the classified or composite rate is generally computed by determining the amount of one year's depreciation for each item or each group of similar items, and by dividing the total depreciation thus obtained by the total cost or other basis of the assets. The average rate so obtained is to be used as long as subsequent additions, retirements, or replacements do not substantially alter the relative proportions of different types of assets in the account. An example of the computation of a classified or composite rate follows:

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Cost or other basis	Estimated useful life Years	Annual depreciation
$10,000	5	$2,000
10,000	15	667
$20,000		$2,667

Average rate is 13.33 percent ($2,667÷ $20,000) unadjusted for salvage. Assuming the estimated salvage value is 10 percent of the cost or other basis, the rate adjusted for salvage will be 13.33 percent (13.33% — 1.33%), or 12 percent.

Example (3). The use of the straight line method for group, classified, or composite accounts is illustrated by the following example: A taxpayer filing his returns on a calendar year basis maintains an asset account for which a group rate of 20 percent has been determined, before adjustment for salvage. Estimated salvage is determined to be 6⅔ percent, resulting in an adjusted rate of 18.67 percent. During the years illustrated, the initial investment, additions, retirements, and salvage recoveries, which were determined not to change the composition of the group sufficiently to require a change in rate, were assumed to have been made as follows:

DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION ON AVERAGE BALANCES

Year	Asset Balance Jan. 1	Current Additions	Current Retirements	Asset Balance Dec. 31	Average Balance	Rate (percent)	Allowable Depreciation
1958		$12,000		$12,000	$ 6,000	18.67	$1,120
1959	$12,000			12,000	12,000	18.67	2,240
1960	12,000			12,000	12,000	18.67	2,240
1961	12,000		$2,000	10,000	11,000	18.67	2,054
1962	10,000		2,000	8,000	9,000	18.67	1,680
1963	8,000	10,000	4,000	14,000	11,000	18.67	2,054
1964	14,000		2,000	12,000	13,000	18.67	2,427
1965	12,000		2,000	10,000	11,000	18.67	2,054

CORRESPONDING DEPRECIATION RESERVE ACCOUNT

Year	Depreciation Reserve Jan. 1	Depreciation Allowable	Current Retirements	Salvage Realized	Depreciation Reserve Dec. 31
1958		$1,120			$1,120
1959	$1,120	2,240			3,360
1960	3,360	2,240			5,600
1961	5,600	2,054	$2,000	$200	5,854
1962	5,854	1,680	2,000	200	5,734
1963	5,734	2,054	4,000	400	4,188
1964	4,188	2,427	2,000		4,615
1965	4,615	2,054	2,000		4,669

1958—Initial investment of $12,000.
1959—Retirement $2,000, salvage realized $200.
1960—Retirement $2,000, salvage realized $200.

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1961—Retirement $4,000, salvage realized $400.

1962—Additions $10,000.

1963—Retirement $2,000, no salvage realized.

1964—Retirement $2,000, no salvage realized.

2009 (7) (A) (b)-2 DECLINING BALANCE METHOD.

(a) Application Of Method. Under the declining balance method a uniform rate is applied each year to the unrecovered cost or other basis of the property. The unrecovered cost or other basis is the basis provided by M.S.A. 290.09, Subd. 7 (A) (f), adjusted for depreciation previously allowed or allowable, and for all other adjustments provided by M.S.A. 290.12, Subd. 2 and other applicable provisions of law. The declining balance rate may be determined without resort to formula. Such rate determined under M.S.A. 290.09, Subd. 7 (A) (b) (2) shall not exceed twice the appropriate straight line rate computed without adjustment for salvage. While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See M.S.A. 290.09, Subd. 7 (A) (c) and 2009 (7) (A) (c)-1 for restrictions on the use of the declining balance method.

(b) Illustrations. The declining balance method is illustrated by the following examples:

Example (1). A new asset having an estimated useful life of 20 years was purchased on January 1, 1958, for $1,000. The normal straight line rate (without adjustment for salvage) is 5 percent, and the declining balance rate at twice the normal straight line rate is 10 percent. The annual depreciaton allowances for 1958, 1959, and 1960 are as follows:

Year	Basis	Declining balance rate (Percent)	Depreciation allowance
1958	$1,000	10	$100
1959	900	10	90
1960	810	10	81

Example (2). A taxpayer filing his returns on a calendar year basis maintains a group account to which a 5 year life and a 40 percent declining balance rate are applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in example (3) of 2009 (7) (A) (b)-1 (b). Although salvage value is not taken into consideration in computing a declining balance rate, it must be recognized and accounted for when assets are retired.

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DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION USING AVERAGE ASSET AND RESERVE BALANCES

Year	Asset Balance Jan. 1	Current Additions	Current Retirements	Asset Balance Dec. 31	Average Balance	Average Reserve Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation
1958	.....	$12,000	.....	$12,000	$ 6,000	.....	$6,000	40	$2,400
1959	$12,000	.....	.....	12,000	12,000	$2,400	9,600	40	3,840
1960	12,000	.....	.....	12,000	12,000	6,240	5,760	40	2,304
1961	12,000	.....	$2,000	10,000	11,000	7,644	3,356	40	1,342
1962	10,000	.....	2,000	8,000	9,000	7,186	1,814	40	726
1963	8,000	10,000	4,000	14,000	11,000	5,212	5,788	40	2,315
1964	14,000	.....	2,000	12,000	13,000	4,727	8,273	40	3,309
1965	12,000	.....	2,000	10,000	11,000	6,036	4,964	40	1,986

DEPRECIATION RESERVE

Year	Reserve Jan. 1	Current Retirements	Salvage Realized	Reserve Dec. 31, Before Depreciation	Average Reserve Before Depreciation	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1958	.....	.....	.....	.....	.....	$2,400	$2,400
1959	$2,400	.....	.....	$2,400	$2,400	3,840	6,240
1960	6,240	.....	.....	6,240	6,240	2,304	8,544
1961	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1962	8,086	2,000	200	6,286	7,186	726	7,012
1963	7,012	4,000	400	3,412	5,212	2,315	5,727
1964	5,727	2,000	.....	3,727	4,727	3,309	7,036
1965	7,036	2,000	.....	5,036	6,036	1,986	7,022

Where separate depreciation accounts are maintained by year of acquisition and there is an unrecovered balance at the time of the last retirement, such unrecovered balance may be deducted as part of the depreciation allowance for the year of such retirement. Thus, if the taxpayer had kept separate depreciation accounts by year of acquisition and all the retirements shown in the example above were from 1958 acquisitions, depreciation would be computed on the 1958 and 1963 acquisitions as follows:

1958 ACQUISITIONS

Year	Asset Balance Jan. 1	Acquisitions	Current Retirements	Asset Balance Dec. 31	Average Balance	Average Reserve Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation
1958	.....	$12,000	.....	$12,000	$ 6,000	.....	$6,000	40	$2,400
1959	$12,000	.....	.....	12,000	12,000	$2,400	9,600	40	3,840
1960	12,000	.....	.....	12,000	12,000	6,240	5,760	40	2,304
1961	12,000	.....	$2,000	10,000	11,000	7,644	3,356	40	1,342
1962	10,000	.....	2,000	8,000	9,000	7,186	1,814	40	726
1963	8,000	.....	4,000	4,000	6,000	5,212	788	40	315
1964	4,000	.....	2,000	2,000	3,000	2,727	273	40	109
1965	2,000	.....	2,000	.....	1,000	836	164	.....	[1] 164

[1]Balance allowable as depreciation in the year of retirement of the last survivor of the 1958 acquisitions.

DEPRECIATION RESERVE FOR 1958 ACQUISITIONS

Year	Reserve Jan. 1	Current Retirements	Salvage Realized	Reserve Dec. 31, Before Depreciation	Average Reserve Before Depreciation	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1958	.....	.....	.....	.....	.....	$2,400	$2,400
1959	$2,400	.....	.....	$2,400	$2,400	3,840	6,240
1960	6,240	.....	.....	6,240	6,240	2,304	8,544
1961	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1962	8,086	2,000	200	6,286	7,186	726	7,012
1963	7,012	4,000	400	3,412	5,212	315	3,727
1964	3,727	2,000	.....	1,727	2,727	109	1,835
1965	1,836	2,000	.....	(164)	836	164	.....

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1963 ACQUISITIONS

Year	Asset Balance Jan. 1	Acquisition	Asset Balance Dec. 31	Average Balance	Reserve Dec. 31, Before Depreciation	Net Depreciable Balance	Rate (percent)	Allowable Depreciation	Reserve Dec. 31, After Depreciation
1963.....	.....	$10,000	$10,000	$ 5,000	None	$5,000	40	$2,000	$2,000
1964 ...	$10,000	.....	10,000	10,000	$2,000	8,000	40	3,200	5,200
1965 ...	10,000	. . .	10,000	10,000	5,200	4,800	40	1,920	7,120

In the above example, the allowable depreciation on the 1958 acquisitions totals $11,200. This amount when increased by salvage realized in the amount of $800, equals the entire cost or other basis of the 1958 acquisitions ($12,000).

(c) Change In Estimated Useful Life. In the declining balance method when a change is justified in the useful life estimated for an account, subsequent computations shall be made as though the revised useful life had been originally estimated. For example, assume that an account has an estimated useful life of ten years and that a declining balance rate of 20 percent is applicable. If, at the end of the sixth year, it is determined that the remaining useful life of the account is six years, computations shall be made as though the estimated useful life was originally determined as twelve years. Accordingly, the applicable depreciation rate will be 16⅔ percent. This rate is thereafter applied to the unrecovered cost or other basis.

2009 (7) (A) (b)-3 SUM OF THE YEARS-DIGITS METHOD

(a) Applied To A Single Asset—(1) General rule. Under the sum of the years-digits method annual allowances for depreciation are computed by applying changing fractions to the cost or other basis of the property reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the asset (including the year for which the allowance is being computed), and the denominator which remains constant is the sum of all the years digits corresponding to the estimated useful life of the asset. See M.S.A. 290.09, Subd. 7 (A) (c) and 2009 (7) (A) (c)-1 for restrictions on the use of the sum of the years-digits methods.

(i) Illustrations. Computation of depreciation allowances on a single asset under the sum of the years-digits method is illustrated by the following examples:

Example (1). A new asset having an estimated useful life of five years was acquired on January 1, 1958, for $1,750. The estimated salvage is $250. For a taxpayer filing his returns on a calendar year basis, the annual depreciation allowances are as follows:

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Year	Cost or Other Basis Less Salvage	Fraction[1]	Allowable Depreciation	Depreciation Reserve
1958	$1,500	5/15	$500	$ 500
1959	1,500	4/15	400	900
1960	1,500	3/15	300	1,200
1961	1,500	2/15	200	1,400
1962	1,500	1/15	100	1,500

Unrecovered value (salvage) $250

[1]The denominator of the fraction is the sum of the digits representing the years of useful life, i. e., 5, 4, 3, 2, and 1, or 15.

Example (2). Assume in connection with an asset acquired in 1958 that three-fourths of a year's depreciation is allowable in that year.

The following illustrates a reasonable method of allocating depreciation:

	Depreciation for 12 Months	Allowable Depreciation		
		1958	1959	1960
1st year	$500	(3/4) $375	(1/4) $125	.....
2nd year	400	.....	(3/4) 300	(1/4) $100
3rd year	300	.....	.....	(3/4) 225
		375	425	325

(ii) Change In Useful Life. Where in the case of a single asset, a change is justified in the useful life, subsequent computations shall be made as though the remaining useful life at the beginning of the taxable year of change were the useful life of a new asset acquired at such time and with a basis equal to the unrecovered cost or other basis of the asset at that time. For example, assume that a new asset with an estimated useful life of ten years is purchased in 1958. At the time of making out his return for 1963, the taxpayer finds that the asset has a remaining useful life of seven years from January 1, 1963. Depreciation for 1963 should then be computed as though 1963 were the first year of the life of an asset estimated to have a useful life of seven years, and the allowance for 1963 would be 7/28 of the unrecovered cost or other basis of the asset after adjustment for salvage.

(2) Remaining Life. (i) Application. Under the sum of the years-digits method, annual allowances for depreciation may also be computed by applying changing fractions to the unrecovered cost or other basis of the asset reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the asset (including the year for which the allowance is being computed), and the denominator changes each year to a number which represents the sum of the digits corresponding to the years of esti-

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mated remaining useful life of the asset. For decimal equivalents of such fractions see Table I below. For example, a new asset with an estimated useful life of 10 years is purchased January 1, 1958, for $6,000. Assuming a salvage value of $500, the depreciation allowance for 1958 is $1,000 ($5,500 x 0.1818, the applicable rate from Table I). For 1959 the unrecovered balance is $4,500, and the remaining life is 9 years. The depreciation allowance for 1959 would then be $900 ($4,500 x 0.2000, the applicable rate from Table I).

(ii) Table I. This table shows decimal equivalents to sum of the years-digits fractions corresponding to remaining lives from 1 to 100 years.

Table I

Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent
100.0	0.0198	98.0	.0202	96.0	.0206	94.0	.0211
99.9	.0198	97.9	.0202	95.9	.0206	93.9	.0211
99.8	.0198	97.8	.0202	95.8	.0207	93.8	.0211
99.7	.0199	97.7	.0203	95.7	.0207	93.7	.0211
99.6	.0199	97.6	.0203	95.6	.0207	93.6	.0211
99.5	.0199	97.5	.0203	95.5	.0207	93.5	.0212
99.4	.0199	97.4	.0203	95.4	.0207	93.4	.0212
99.3	.0199	97.3	.0203	95.3	.0208	93.3	.0212
99.2	.0200	97.2	.0204	95.2	.0208	93.2	.0212
99.1	.0200	97.1	.0204	95.1	.0208	93.1	.0213
99.0	.0200	97.0	.0204	95.0	.0208	93.0	.0213
98.9	.0200	96.9	.0204	94.9	.0209	92.9	.0213
98.8	.0200	96.8	.0204	94.8	.0209	92.8	.0213
98.7	.0201	96.7	.0205	94.7	.0209	92.7	.0213
98.6	.0201	96.6	.0205	94.6	.0209	92.6	.0214
98.5	.0201	96.5	.0205	94.5	.0209	92.5	.0214
98.4	.0201	96.4	.0205	94.4	.0210	92.4	.0214
98.3	.0201	96.3	.0206	94.3	.0210	92.3	.0214
98.2	.0202	96.2	.0206	94.2	.0210	92.2	.0215
98.1	.0202	96.1	.0206	94.1	.0210	92.1	.0215

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Table I — (continued)

Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent
92.0	.0215	86.3	.0229	80.6	.0245	74.9	.0264
91.9	.0215	86.2	.0229	80.5	.0245	74.8	.0264
91.8	.0216	86.1	.0230	80.4	.0246	74.7	.0264
91.7	.0216	86.0	.0230	80.3	.0246	74.6	.0265
91.6	.0216	85.9	.0230	80.2	.0246	74.5	.0265
91.5	.0216	85.8	.0230	80.1	.0247	74.4	.0265
91.4	.0216	85.7	.0231	80.0	.0247	74.3	.0266
91.3	.0217	85.6	.0231	79.9	.0247	74.2	.0266
91.2	.0217	85.5	.0231	79.8	.0248	74.1	.0266
91.1	.0217	85.4	.0231	79.7	.0248	74.0	.0267
91.0	.0217	85.3	.0232	79.6	.0248	73.9	.0267
90.9	.0218	85.2	.0232	79.5	.0248	73.8	.0267
90.8	.0218	85.1	.0232	79.4	.0249	73.7	.0268
90.7	.0218	85.0	.0233	79.3	.0249	73.6	.0268
90.6	.0218	84.9	.0233	79.2	.0249	73.5	.0268
90.5	.0219	84.8	.0233	79.1	.0250	73.4	.0269
90.4	.0219	84.7	.0233	79.0	.0250	73.3	.0269
90.3	.0219	84.6	.0234	78.9	.0250	73.2	.0270
90.2	.0219	84.5	.0234	78.8	.0251	73.1	.0270
90.1	.0220	84.4	.0234	78.7	.0251	73.0	.0270
90.0	.0220	84.3	.0234	78.6	.0251	72.9	.0271
89.9	.0220	84.2	.0235	78.5	.0252	72.8	.0271
89.8	.0220	84.1	.0235	78.4	.0252	72.7	.0271
89.7	.0221	84.0	.0235	78.3	.0252	72.6	.0272
89.6	.0221	83.9	.0236	78.2	.0253	72.5	.0272
89.5	.0221	83.8	.0236	78.1	.0253	72.4	.0272
89.4	.0221	83.7	.0236	78.0	.0253	72.3	.0273
89.3	.0221	83.6	.0236	77.9	.0253	72.2	.0273
89.2	.0222	83.5	.0237	77.8	.0254	72.1	.0274
89.1	.0222	83.4	.0237	77.7	.0254	72.0	.0274
89.0	.0222	83.3	.0237	77.6	.0254	71.9	.0274
88.9	.0222	83.2	.0238	77.5	.0255	71.8	.0275
88.8	.0223	83.1	.0238	77.4	.0255	71.7	.0275
88.7	.0223	83.0	.0238	77.3	.0255	71.6	.0275
88.6	.0223	82.9	.0238	77.2	.0256	71.5	.0276
88.5	.0223	82.8	.0239	77.1	.0256	71.4	.0276
88.4	.0224	82.7	.0239	77.0	.0256	71.3	.0277
88.3	.0224	82.6	.0239	76.9	.0257	71.2	.0277
88.2	.0224	82.5	.0240	76.8	.0257	71.1	.0277
88.1	.0224	82.4	.0240	76.7	.0257	71.0	.0278
88.0	.0225	82.3	.0240	76.6	.0258	70.9	.0278
87.9	.0225	82.2	.0240	76.5	.0258	70.8	.0279
87.8	.0225	82.1	.0241	76.4	.0258	70.7	.0279
87.7	.0225	82.0	.0241	76.3	.0259	70.6	.0279
87.6	.0226	81.9	.0241	76.2	.0259	70.5	.0280
87.5	.0226	81.8	.0242	76.1	.0259	70.4	.0280
87.4	.0226	81.7	.0242	76.0	.0260	70.3	.0280
87.3	.0226	81.6	.0242	75.9	.0260	70.2	.0281
87.2	.0227	81.5	.0242	75.8	.0260	70.1	.0281
87.1	.0227	81.4	.0243	75.7	.0261	70.0	.0282
87.0	.0227	81.3	.0243	75.6	.0261	69.9	.0282
86.9	.0228	81.2	.0243	75.5	.0261	69.8	.0282
86.8	.0228	81.1	.0244	75.4	.0262	69.7	.0283
86.7	.0228	81.0	.0244	75.3	.0262	69.6	.0283
86.6	.0228	80.9	.0244	75.2	.0262	69.5	.0284
86.5	.0229	80.8	.0244	75.1	.0263	69.4	.0284
86.4	.0229	80.7	.0245	75.0	.0263	69.3	.0284

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Table I — (continued)

Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent
69.2	.0285	63.5	.0310	57.8	.0340	52.1	.0377
69.1	.0285	63.4	.0311	57.7	.0341	52.0	.0377
69.0	.0286	63.3	.0311	57.6	.0341	51.9	.0378
68.9	.0286	63.2	.0312	57.5	.0342	51.8	.0379
68.8	.0287	63.1	.0312	57.4	.0342	51.7	.0379
68.7	.0287	63.0	.0313	57.3	.0343	51.6	.0380
68.6	.0287	62.9	.0313	57.2	.0344	51.5	.0381
68.5	.0288	62.8	.0313	57.1	.0344	51.4	.0382
68.4	.0288	62.7	.0314	57.0	.0345	51.3	.0382
68.3	.0289	62.6	.0314	56.9	.0345	51.2	.0383
68.2	.0289	62.5	.0315	56.8	.0346	51.1	.0384
68.1	.0289	62.4	.0315	56.7	.0347	51.0	.0385
68.0	.0290	62.3	.0316	56.6	.0347	50.9	.0385
67.9	.0290	62.2	.0316	56.5	.0348	50.8	.0386
67.8	.0291	62.1	.0317	56.4	.0348	50.7	.0387
67.7	.0291	62.0	.0317	56.3	.0349	50.6	.0388
67.6	.0292	61.9	.0318	56.2	.0350	50.5	.0388
67.5	.0292	61.8	.0318	56.1	.0350	50.4	.0389
67.4	.0292	61.7	.0319	56.0	.0351	50.3	.0390
67.3	.0293	61.6	.0319	55.9	.0351	50.2	.0391
67.2	.0293	61.5	.0320	55.8	.0352	50.1	.0391
67.1	.0294	61.4	.0320	55.7	.0353	50.0	.0392
67.0	.0294	61.3	.0321	55.6	.0353	49.9	.0393
66.9	.0295	61.2	.0322	55.5	.0354	49.8	.0394
66.8	.0295	61.1	.0322	55.4	.0355	49.7	.0394
66.7	.0295	61.0	.0323	55.3	.0355	49.6	.0395
66.6	.0296	60.9	.0323	55.2	.0356	49.5	.0396
66.5	.0296	60.8	.0324	55.1	.0356	49.4	.0397
66.4	.0297	60.7	.0324	55.0	.0357	49.3	.0398
66.3	.0297	60.6	.0325	54.9	.0358	49.2	.0398
66.2	.0298	60.5	.0325	54.8	.0358	49.1	.0399
66.1	.0298	60.4	.0326	54.7	.0359	49.0	.0400
66.0	.0299	60.3	.0326	54.6	.0360	48.9	.0401
65.9	.0299	60.2	.0327	54.5	.0360	48.8	.0402
65.8	.0299	60.1	.0327	54.4	.0361	48.7	.0402
65.7	.0300	60.0	.0328	54.3	.0362	48.6	.0403
65.6	.0300	59.9	.0328	54.2	.0362	48.5	.0404
65.5	.0301	59.8	.0329	54.1	.0363	48.4	.0405
65.4	.0301	59.7	.0329	54.0	.0364	48.3	.0406
65.3	.0302	59.6	.0330	53.9	.0364	48.2	.0406
65.2	.0302	59.5	.0331	53.8	.0365	48.1	.0407
65.1	.0303	59.4	.0331	53.7	.0366	48.0	.0408
65.0	.0303	59.3	.0332	53.6	.0366	47.9	.0409
64.9	.0303	59.2	.0332	53.5	.0367	47.8	.0410
64.8	.0304	59.1	.0333	53.4	.0368	47.7	.0411
64.7	.0304	59.0	.0333	53.3	.0368	47.6	.0411
64.6	.0305	58.9	.0334	53.2	.0369	47.5	.0412
64.5	.0305	58.8	.0334	53.1	.0370	47.4	.0413
64.4	.0306	58.7	.0335	53.0	.0370	47.3	.0414
64.3	.0306	58.6	.0336	52.9	.0371	47.2	.0415
64.2	.0307	58.5	.0336	52.8	.0372	47.1	.0416
64.1	.0307	58.4	.0337	52.7	.0372	47.0	.0417
64.0	.0308	58.3	.0337	52.6	.0373	46.9	.0418
63.9	.0308	58.2	.0338	52.5	.0374	46.8	.0418
63.8	.0309	58.1	.0338	52.4	.0374	46.7	.0419
63.7	.0309	58.0	.0339	52.3	.0375	46.6	.0420
63.6	.0310	57.9	.0340	52.2	.0376	46.5	.0421

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Table I — (continued)

Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent
46.4	.0422	40.7	.0480	35.0	.0556	29.3	.0660
46.3	.0423	40.6	.0481	34.9	.0557	29.2	.0662
46.2	.0424	40.5	.0482	34.8	.0559	29.1	.0664
46.1	.0425	40.4	.0483	34.7	.0560	29.0	.0667
46.0	.0426	40.3	.0484	34.6	.0562	28.9	.0669
45.9	.0426	40.2	.0485	34.5	.0563	28.8	.0671
45.8	.0427	40.1	.0487	34.4	.0565	28.7	.0673
45.7	.0428	40.0	.0488	34.3	.0566	28.6	.0675
45.6	.0429	39.9	.0489	34.2	.0568	28.5	.0678
45.5	.0430	39.8	.0490	34.1	.0570	28.4	.0680
45.4	.0431	39.7	.0491	34.0	.0571	28.3	.0682
45.3	.0432	39.6	.0493	33.9	.0573	28.2	.0685
45.2	.0433	39.5	.0494	33.8	.0575	28.1	.0687
45.1	.0434	39.4	.0495	33.7	.0576	28.0	.0690
45.0	.0435	39.3	.0496	33.6	.0578	27.9	.0692
44.9	.0436	39.2	.0497	33.5	.0580	27.8	.0694
44.8	.0437	39.1	.0499	33.4	.0581	27.7	.0697
44.7	.0438	39.0	.0500	33.3	.0583	27.6	.0699
44.6	.0439	38.9	.0501	33.2	.0585	27.5	.0702
44.5	.0440	38.8	.0502	33.1	.0586	27.4	.0704
44.4	.0440	38.7	.0504	33.0	.0588	27.3	.0707
44.3	.0441	38.6	.0505	32.9	.0590	27.2	.0709
44.2	.0442	38.5	.0506	32.8	.0592	27.1	.0712
44.1	.0443	38.4	.0508	32.7	.0593	27.0	.0714
44.0	.0444	38.3	.0509	32.6	.0595	26.9	.0717
43.9	.0445	38.2	.0510	32.5	.0597	26.8	.0719
43.8	.0446	38.1	.0511	32.4	.0599	26.7	.0722
43.7	.0447	38.0	.0513	32.3	.0600	26.6	.0724
43.6	.0448	37.9	.0514	32.2	.0602	26.5	.0727
43.5	.0449	37.8	.0515	32.1	.0604	26.4	.0730
43.4	.0450	37.7	.0517	32.0	.0606	26.3	.0732
43.3	.0451	37.6	.0518	31.9	.0608	26.2	.0735
43.2	.0452	37.5	.0519	31.8	.0610	26.1	.0738
43.1	.0453	37.4	.0521	31.7	.0611	26.0	.0741
43.0	.0455	37.3	.0522	31.6	.0613	25.9	.0743
42.9	.0456	37.2	.0524	31.5	.0615	25.8	.0746
42.8	.0457	37.1	.0525	31.4	.0617	25.7	.0749
42.7	.0458	37.0	.0526	31.3	.0619	25.6	.0752
42.6	.0459	36.9	.0528	31.2	.0621	25.5	.0754
42.5	.0460	36.8	.0529	31.1	.0623	25.4	.0757
42.4	.0461	36.7	.0530	31.0	.0625	25.3	.0760
42.3	.0462	36.6	.0532	30.9	.0627	25.2	.0763
42.2	.0463	36.5	.0533	30.8	.0629	25.1	.0766
42.1	.0464	36.4	.0535	30.7	.0631	25.0	.0769
42.0	.0465	36.3	.0536	30.6	.0633	24.9	.0772
41.9	.0466	36.2	.0538	30.5	.0635	24.8	.0775
41.8	.0467	36.1	.0539	30.4	.0637	24.7	.0778
41.7	.0468	36.0	.0541	30.3	.0639	24.6	.0781
41.6	.0469	35.9	.0542	30.2	.0641	24.5	.0784
41.5	.0471	35.8	.0543	30.1	.0643	24.4	.0787
41.4	.0472	35.7	.0545	30.0	.0645	24.3	.0790
41.3	.0473	35.6	.0546	29.9	.0647	24.2	.0793
41.2	.0474	35.5	.0548	29.8	.0649	24.1	.0797
41.1	.0475	35.4	.0549	29.7	.0651	24.0	.0800
41.0	.0476	35.3	.0551	29.6	.0653	23.9	.0803
40.9	.0477	35.2	.0552	29.5	.0656	23.8	.0806
40.8	.0478	35.1	.0554	29.4	.0658	23.7	.0809

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Table I — (continued)

Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent	Remaining life (years)	Decimal equivalent
23.6	.0813	17.9	.1058	12.2	.1514	6.5	.2658
23.5	.0816	17.8	.1063	12.1	.1526	6.4	.2689
23.4	.0819	17.7	.1069	12.0	.1538	6.3	.2727
23.3	.0823	17.6	.1074	11.9	.1549	6.2	.2768
23.2	.0826	17.5	.1080	11.8	.1561	6.1	.2811
23.1	.0830	17.4	.1086	11.7	.1573	6.0	.2857
23.0	.0833	17.3	.1092	11.6	.1585	5.9	.2892
22.9	.0837	17.2	.1098	11.5	.1597	5.8	.2929
22.8	.0840	17.1	.1105	11.4	.1610	5.7	.2969
22.7	.0844	17.0	.1111	11.3	.1624	5.6	.3011
22.6	.0847	16.9	.1117	11.2	.1637	5.5	.3056
22.5	.0851	16.8	.1123	11.1	.1652	5.4	.3103
22.4	.0854	16.7	.1129	11.0	.1667	5.3	.3155
22.3	.0858	16.6	.1135	10.9	.1680	5.2	.3210
22.2	.0862	16.5	.1142	10.8	.1693	5.1	.3269
22.1	.0866	16.4	.1148	10.7	.1707	5.0	.3333
22.0	.0870	16.3	.1155	10.6	.1721	4.9	.3379
21.9	.0873	16.2	.1162	10.5	.1736	4.8	.3429
21.8	.0877	16.1	.1169	10.4	.1751	4.7	.3481
21.7	.0881	16.0	.1176	10.3	.1767	4.6	.3538
21.6	.0885	15.9	.1183	10.2	.1783	4.5	.3600
21.5	.0888	15.8	.1190	10.1	.1800	4.4	.3667
21.4	.0892	15.7	.1197	10.0	.1818	4.3	.3739
21.3	.0896	15.6	.1204	9.9	.1833	4.2	.3818
21.2	.0901	15.5	.1211	9.8	.1849	4.1	.3905
21.1	.0905	15.4	.1218	9.7	.1865	4.0	.4000
21.0	.0909	15.3	.1226	9.6	.1882	3.9	.4063
20.9	.0913	15.2	.1234	9.5	.1900	3.8	.4130
20.8	.0917	15.1	.1242	9.4	.1918	3.7	.4205
20.7	.0921	15.0	.1250	9.3	.1938	3.6	.4286
20.6	.0925	14.9	.1257	9.2	.1957	3.5	.4375
20.5	.0930	14.8	.1265	9.1	.1978	3.4	.4474
20.4	.0934	14.7	.1273	9.0	.2000	3.3	.4583
20.3	.0939	14.6	.1281	8.9	.2018	3.2	.4706
20.2	.0943	14.5	.1289	8.8	.2037	3.1	.4844
20.1	.0948	14.4	1297	8.7	.2057	3.0	.5000
20.0	.0952	14.3	.1306	8.6	.2077	2.9	.5088
19.9	.0957	14.2	.1315	8.5	.2099	2.8	.5185
19.8	.0961	14.1	.1324	8.4	.2121	2.7	.5294
19.7	.0966	14.0	.1333	8.3	.2145	2.6	.5417
19.6	.0970	13.9	.1342	8.2	.2169	2.5	.5556
19.5	.0975	13.8	.1350	8.1	.2195	2.4	.5714
19.4	.0980	13.7	.1359	8.0	.2222	2.3	.5897
19.3	.0985	13.6	.1368	7.9	.2244	2.2	.6111
19.2	.0990	13.5	.1378	7.8	.2267	2.1	.6364
19.1	.0995	13.4	.1387	7.7	.2292	2.0	.6667
19.0	.1000	13.3	.1397	7.6	.2317	1.9	.6786
18.9	.1005	13.2	.1407	7.5	.2344	1.8	.6923
18.8	.1010	13.1	.1418	7.4	.2372	1.7	.7083
18.7	.1015	13.0	.1429	7.3	.2401	1.6	.7273
18.6	.1020	12.9	.1438	7.2	.2432	1.5	.7500
18.5	.1025	12.8	.1448	7.1	.2465	1.4	.7778
18.4	.1030	12.7	.1458	7.0	.2500	1.3	.8125
18.3	.1036	12.6	.1469	6.9	.2527	1.2	.8571
18.2	.1041	12.5	.1479	6.8	.2556	1.1	.9167
18.1	.1047	12.4	.1490	6.7	.2587	1.0	1.0000
18.0	.1053	12.3	.1502	6.6	.2619		

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Note: For determination of decimal equivalents of remaining lives falling between those shown in the above table, the taxpayer may use the next longest life shown in the table, interpolate from the table, or use the following formula from which the table was derived.

$$D = \frac{2R}{(W+2F)\quad(W+1)}$$

where:

D = Decimal equivalent.

R = Remaining life.

W = Whole number of years in remaining life.

F = Fractional part of year in remaining life. If the taxpayer desires to carry his calculations of decimal equivalents to a greater number of decimal places than is provided in the table, he may use the formula. The procedure adopted must be consistently followed thereafter.

(b) Applied To Group, Classified, Or Composite Accounts. (1) General Rule. The sum of the years-digits method may be applied to group, classified, or composite accounts in accordance with the plan described in subparagraph (2) of this paragraph or in accordance with other plans as explained in subparagraph (3) of this paragraph.

(2) Remaining Life Plan. The remaining life plan as applied to a single asset is described in 2009 (7) (A) (b)-3 (a) (2). This plan may also be applied to group, classified, or composite accounts. Under this plan the allowance for depreciation is computed by applying changing fractions to the unrecovered cost or other basis of the account reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the account (including the year for which the allowance is being computed), and the denominator changes each year to a number which represents the sum of the years digits corresponding to the years of estimated remaining useful life of the account. Decimal equivalents of such fractions can be obtained by use of Table I under 2009 (7) (A) (b)-3 (a) (2) (ii). The proper application of this method requires that the estimated remaining useful life of the account be determined each year.

This determination, of course, may be made each year by analysis, i. e., by determining the remaining lives for each of the components in the account, and averaging them. The estimated remaining life of any account, however, may also be determined arithmetically. For example, it may be computed by dividing the unrecovered cost or other basis of the account, as computed by straight line depreciation, by the gross cost or other basis of the account, and multiplying the result by the average life of

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Depreciation Computations on a Group Account Under Remaining Life Plan

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14
											Sum of the Years Digits Depreciation			
	Asset Balance Jan. 1	Current Additions	Current Retirements	Average Asset Balance	Straight Line Amount	Straight Line Reserve	Remaining Life	Asset Balance Reduced by Salvage	Current Additions reduced by Salvage	Salvage Realized	Accumulated Reserve Jan. 1	Unrecovered Jan. 1	Rate Based on Col. (7) from Table I	Allowable Depreciation
					Col. (4)÷ Life	Col. (5)− Col. (3) Accumulated Jan. 1	[Col. (1)− Col. (6)÷ Col. (1)] × Average Service Life	Col. (1)× (100%− 6.67%)	Col. (2)× (100%− 6.67%)		Prior Reserve+ Col. (14)+ Col. (10)− Col. (3)	Col. (8)− Col. (11)		Col. (12)× Col. (13)+ ½ Col. (9) ×F[2]
1958		$12,000		$ 6,000	[1]$1,200		5.00		$11,200				0.3333	$1,866
1959	$12,000			12,000	2,400	$1,200	4.50	$11,200			$1,866	$9,334	.3600	3,360
1960	12,000			12,000	2,400	3,600	3.50	11,200			5,226	5,974	.4375	2,614
1961	12,000		$2,000	11,000	2,200	6,000	2.50	11,200		$200	7,840	3,360	.5556	1,867
1962	10,000		2,000	9,000	1,800	6,200	1.90	9,333		200	7,907	1,426	.6786	968
1963	8,000	10,000	4,000	11,000	2,200	6,000	1.25	7,466	9,333	400	7,075	391	.8125	1,874
1964	14,000		2,000	13,000	2,600	4,200	3.50	13,066			5,349	7,717	.4375	3,376
1965	12,000		2,000	11,000	2,200	4,800	3.00	11,200			6,725	4,475	.5000	2,238
1966						5,000					6,963			

[1] ½ year's amount.
[2] F = Rate based on average service life (0.3333 in this example).

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the assets in the account. Salvage value is not a factor for the purpose of determining remaining life. Thus, if a group account with an average life of ten years had at January 1, 1958, a gross asset balance of $12,600 and a depreciation reserve computed on the straight line method of $9,450, the remaining life of the account at January 1, 1958, would be computed as follows:

$$\frac{\$12,600 - \$9,450}{\$12,600} \text{ times 10 years equals 2.50 years.}$$

Example. The use of the sum of the years-digits method with group, classified, or composite accounts under the remaining life plan is illustrated by the following example: A calendar year taxpayer maintains a group account to which a five-year life is applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in example (3) of 2009 (7) (A) (b)-1 (b).

(3) Other Plans For Application Of The Sum Of The Years-Digits Method. Taxpayers who wish to use the sum of the years-digits method in computing depreciation for group, classified, or composite accounts in accordance with a sum of the years-digits plan other than the remaining life plan described herein may do so only with the consent of the Commissioner. Request for permission to use plans other than that described shall be addressed to the Commissioner of Taxation, St. Paul, Minnesota.

2009 (7) (A) (b)-4 OTHER METHODS

(a) Under M.S.A. 290.09, Subd. 7 (A) (b) (4) a taxpayer may use any consistent method of computing depreciation, such as the sinking fund method, provided depreciation allowances computed in accordance with such method do not result in accumulated allowances at the end of any taxable year greater than the total of the accumulated allowances which could have resulted from the use of the declining balance method described in M.S.A. 290.09, Subd. 7 (A) (b) (2). This limitation applies only during the first two-thirds of the useful life of the property. For example, an asset costing $1,000 having a useful life of six years may be depreciated under the declining balance method in accordance with 2009 (7) (A) (b)-2, at a rate of 33⅓ percent. During the first four years or ⅔ of its useful life, maximum depreciation allowances under the declining balance method would be as follows:

	Current depreciation	Accumulated depreciation	Balance
Cost of asset			$1,000
First year	$333	$333	667
Second year	222	555	445
Third year	148	703	297
Fourth year	99	802	198

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An annual allowance computed by any other method under M.S.A. 290.09, Subd. 7 (A) (b) (4) could not exceed $333 for the first year, and at the end of the second year the total allowances for the two years could not exceed $555. Likewise, the total allowances for the three years could not exceed $703 and for the four years could not exceed $802. This limitation would not apply in the fifth and sixth years. See M.S.A. 290.09, Subd. 7 (A) (c) and 2009 (7) (A) (c)-1 for restrictions on the use of certain methods.

(b) It shall be the responsibility of the taxpayer to establish to the satisfaction of the Commissioner that a method of depreciation under M.S.A. 290.09, Subd. 7 (A) (b) (4) is both a reasonable and consistent method and that it does not produce depreciation allowances in excess of the amount permitted under the limitations provided in such section.

2009 (7) (A) (c)-1 LIMITATIONS ON METHODS OF COMPUTING DEPRECIATION UNDER M.S.A. 290.09, Subd. 7 (A) (b) (2), (3), and (4).

(a) In General. (1) M.S.A. 290.09 Subd. 7 (A) (c) provides limitations on the use of the declining balance method described in M.S.A. 290.09 Subd. 7 (A) (b) (2), the sum of the years-digits method described in M.S.A. 290.09, Subd. 7 (A) (b) (3), and certain other methods authorized by M.S.A. 290.09, Subd. 7 (A) (b) (4). These methods are applicable only to tangible property having a useful life of three years or more. These methods apply only to that portion of the basis of the property which is properly attributable to such construction, reconstruction, or erection after December 31, 1958. Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with specifications. The portion of the basis of such property attributable to construction, reconstruction, or erection after December 31, 1958, consists of all costs of the property allocable to the period after December 31, 1958, including the cost or other basis of materials entering into such work. It is not necessary that such materials be acquired after December 31, 1958, or that they be new in use. If construction or erection by the taxpayer began after December 31, 1958, the entire cost or other basis of such construction or erection qualifies for these methods of depreciation. In the case of reconstruction of property, these methods do not apply to any part of the adjusted basis of such property on December 31, 1958. For purposes of this section, construction, reconstruction, or erection by the taxpayer begins when physical work is started on such construction, reconstruction, or erection.

(2) If the property was not constructed, reconstructed, or erected by the taxpayer, these methods apply only if it was acquired after December 31, 1958, and if the original use of the property commences with the taxpayer and commences after

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December 31, 1958. For the purpose of the preceding sentence, property shall be deemed to be acquired when reduced to physical possession, or control. The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use for such property by the taxpayer. For example, a reconditioned or rebuilt machine acquired after December 31, 1958, will not be treated as being put to original use by the taxpayer even though it is put to a different use, nor will a horse acquired for breeding purposes be treated as being put to original use by the taxpayer if prior to the purchase the horse was used for racing purposes. See 2009 (7) (A) (b)-2, 2009 (7) (A) (b)-3, and 2009 (7), (A) (b)-4 for application of the various methods.

(3) Assets having an estimated average useful life of less than three years shall not be included in a group, classified, or composite account to which the methods described in 2009 (7) (A) (b)-2, 2009 (7) (A) (b)-3, and 2009 (7) (A) (b)-4 are applicable. However, an incidental retirement of an asset from such account prior to the expiration of a useful life of three years will not prevent the application of these methods to such an account.

(4) See M.S.A. 290.138, Subd. 1 (c) (6) and the regulations thereunder for rules covering the use of depreciation methods by acquiring corporations in the case of certain corporate acquisitions.

(5) Except in the cases described in subparagraphs (4) and (5) of this paragraph, the methods of depreciation described in 2009 (7) (A) (b)-2, 2009 (7) (A) (b)-3, and 2009 (7) (A) (b)-4 are not applicable to property in the hands of a distributee, vendee, transferee, donee, or grantee unless the original use of the property begins with such person and the conditions required by M.S.A. 290.09, Subd. 7 (A) (c) and this section are otherwise met. For example, these methods of depreciation may not be used by a corporation with respect to property which it acquires from an individual or partnership in exchange for its stock. Similarly, if an individual or partnership receives property in a distribution upon dissolution of a corporation, these methods of depreciation may not be used with respect to property so acquired by such individual or partnership. As a further example, these methods of depreciation may not be used by a partnership with respect to contributed property, nor by a partner with respect to partnership property distributed to him. Moreover, where a partnership is entitled to use these depreciation methods, and the optional adjustment to basis of partnership property provided by M.S.A. 290.31, Subd. 20 is applicable, (i) in the case of an increase in the adjusted basis of the partnership property under such section, the transferee partner with respect to whom such adjustment is applicable shall not be entitled to use such methods with respect to such increase, and (ii) in the case of a decrease in the adjusted basis of the partnership property under such section, the trans-

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feree partner with respect to whom such adjustment is applicable shall include in his income an amount equal to the portion of the depreciation deducted by the partnership which is attributable to such decrease.

(b) Illustrations. (1) The application of these methods to property constructed, reconstructed, or erected by the taxpayer after December 31, 1958, may be illustrated by the following examples:

Example (1). If a building with a total cost of $100,000 is completed after December 31, 1958, and the portion attributable to construction after December 31, 1958, is determined by engineering estimates or by cost accounting records to be $30,000, the methods referred to in paragraph (a) (1) above, are applicable only to the $30,000 portion of the total.

Example (2). In 1958, a taxpayer has an old machine with an unrecovered cost of $1,000. If he contracts to have it reconditioned, or reconditions it himself, at a cost of an additional $5,000, only the $5,000 may be depreciated under the methods referred to in paragraph (a) (1) above, whether or not the materials used for reconditioning are new in use.

Example (3). A taxpayer who acquired a building in 1940 makes major maintenance or repair expenditures in 1958 of a type which must be capitalized. For these expenditures the taxpayer may use a method of depreciation different from that used on the building (for example, the methods referred to in paragraph (a) (1) above) only if he accounts for such expenditures separately from the account which contained the original building. In such case, the unadjusted basis on any parts replaced shall be removed from the asset account and shall be charged to the appropriate depreciation reserve account. In the alternative he may capitalize such expenditures by charging them to the depreciation reserve account for the building.

(2) The application of these methods to property which was not constructed, reconstructed, or erected by the taxpayer but which was acquired after December 31, 1958, may be illustrated by the following examples:

Example (1). A taxpayer contracted in 1958 to purchase a new machine which he acquired in 1959 and put into first use in that year. He may use the methods referred to in paragraph (a) (1) above, in recovering the cost of the new machine.

Example (2). A taxpayer instead of reconditioning his old machine buys a "factory reconditioned" machine in 1958 to replace it. He cannot apply the methods referred to in paragraph (a) (1) above, to any part of the cost of the reconditioned machine since he is not the first user of the machine.

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Example (3). In 1958, a taxpayer buys a house for $20,000 which had been used as a personal residence and thus had not been subject to depreciation allowances. He makes a capital addition of $5,000 and rents the property to another. The taxpayer may use the methods referred to in paragraph (a) (1) above, only with respect to the $5,000 cost of the addition.

(c) Election To Use Methods. Subject to the limitations set forth in paragraph (a) of this section, the methods of computing the allowance for depreciation specified in M.S.A. 290.09, Subd. 7 (A) (b) (2) (3), and (4) may be adopted without permission and no formal election is required. In order for a taxpayer to elect to use these methods for any property described in paragraph (a) of this section, he need only compute depreciation thereon under any of these methods for any taxable year ending after December 31, 1958, in which the property may first be depreciated by him. The election with respect to any property shall not be binding with respect to acquisitions of similar property in the same year or subsequent years which are set up in separate accounts.

2009 (7) (A) (d)-1 AGREEMENT AS TO USEFUL LIFE AND RATES OF DEPRECIATION.

For taxable years beginning after December 31, 1958, a taxpayer may enter into an agreement with respect to the estimated useful life, method, and rate of depreciation and treatment of salvage of any property which is subject to the allowance for depreciation. An application for such agreement may be made to the Commissioner of Taxation. Such application shall be filed in quadruplicate and shall contain in such detail as may be practical the following information:

(a) The character and location of the property.

(b) The original cost or other basis and date of acquisition.

(c) Proper adjustments to the basis including depreciation accumulated to the first taxable year to be covered by the agreement.

(d) Estimated useful life and estimated salvage value.

(e) Method and rate of depreciation.

(f) Any other facts and circumstances pertinent to making a reasonable estimate of the useful life of the property and its salvage value.

The agreement must be in writing and must be signed by the taxpayer and by the Commissioner of Taxation or by his agent. The agreement must be signed in quadruplicate, and two of the signed copies will be returned to the taxpayer. The agreement shall set forth its effective date, the estimated remaining useful life, the estimated salvage value, and rate and method of depreciation of the property and the facts and circumstances

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taken into consideration in adoption of the agreement, and shall relate only to depreciation allowances for such property on and after the effective date of the agreement. Such an agreement shall be binding on both parties until such time as facts and circumstances which were not taken into account in making the agreement are shown to exist. The party wishing to modify or change the agreement shall have the responsibility of establishing the existence of such facts and circumstances. Any change in the useful life or rate specified in such agreement shall be effective only prospectively, that is, it shall be effective beginning with the taxable year in which notice of the intention to change, including facts and circumstances warranting the adjustment of useful life and rate, is sent by registered mail by the party proposing the change to the other party. A copy of the agreement (and any modification thereof) shall be filed with the taxpayer's return for the first taxable year which is affected by the agreement (or any modification thereof). A signed copy should be retained with the permanent records of the taxpayer. For rules relating to changes in method of depreciation, see 2009 (7) (A) (e)-1 and M.S.A. 290.07, Subd. 2 and the regulations thereunder.

2009 (7) (A) (e)-1 CHANGE IN METHOD

(a) In General. Any change in the method of computing the depreciation allowances with respect to a particular account is a change in method of accounting, and such a change will be permitted only with the consent of the Commissioner, except that the change from the declining balance method to the straight line method as provided in M.S.A. 290.09, Subd. 7 (A) (e) shall be permitted without consent. See paragraph (b) of this section. A change in method of computing depreciation will be permitted only with respect to all the assets contained in a particular account as defined in 2009 (7) (A) (a)-7. Any change in the percentage of the current straight line rate under the declining balance method, as for example, from 200 percent of the straight line rate to any other percent of the straight line rate, or any change in the interest factor used in connection with a compound interest or sinking fund method will constitute a change in method of depreciation and will require the consent of the Commissioner. Any request for a change in method of depreciation shall be made in accordance with M.S.A. 290.07, Subd. 2 and the regulations thereunder and shall state the character and location of the property, method of depreciation being used and the method proposed, the date of acquisition, the cost or other basis and adjustments thereto, amounts recovered through depreciation and other allowances, the estimated salvage value, the estimated remaining life of the property, and such other information as may be required. For rules covering the use of depreciation methods by acquiring corporations in the case of certain corporate acquisitions, see M.S.A. 290.138, Subd. 1 (c) (6) and the regulations thereunder.

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(b) Declining Balance To Straight Line. In the case of an account to which the method described in M.S.A. 290.09, Subd. 7 (A) (b) (2) is applicable, a taxpayer may change without the consent of the Commissioner, from the declining balance method of depreciation to the straight line method at any time during the useful life of the property under the following conditions. Such a change may not be made if a provision prohibiting such a change is contained in an agreement under M.S.A. 290.09, Subd. 7 (A) (d). When the change is made, the unrecovered cost or other basis (less a reasonable estimate for salvage) shall be recovered through annual allowances over the estimated remaining useful life determined in accordance with the circumstances existing at that time. With respect to any account, this change will be permitted only if applied to all the assets in the account as defined in 2009 (7) (A) (a)-7. The taxpayer shall furnish a statement, with respect to the property which is the subject of the change, showing the date of acquisition, cost or other basis, amounts recovered through depreciation and other allowances, the estimated salvage value, the character of the property, the remaining useful life of the property, and such other information as may be required. The statement shall be attached to the taxpayer's return for the taxable year in which the change is made. A change to the straight line method must be adhered to for the entire taxable year of the change and for all subsequent taxable years unless, with the consent of the Commissioner, a change to another method is permitted.

2009 (7) (A) (f)-1 BASIS FOR DEPRECIATION.

The basis upon which the allowance for depreciation is to be computed with respect to any property shall be the adjusted basis provided in M.S.A. 290.16, Subd. 5 and 6 for the purpose of determining gain on the sale or other disposition of such property. In the case of property which has not been used in the trade or business or held for the production of income and which is thereafter converted to such use, the fair market value on the date of such conversion, if less than the adjusted basis of the property at that time, is the basis for computing depreciation.

2009 (7) (A) (g)-1 LIFE TENANTS AND BENEFICIARIES OF TRUSTS AND ESTATES.

(a) Life Tenants. In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, shall be allowed to the remainderman.

(b) Trusts. If property is held in trust, the allowable deduction is to be apportioned between the income beneficiaries and

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the trustee on the basis of the trust income allocable to each, unless the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depreciation in any amount. In the latter case, the deduction is first allocated to the trustee to the extent that income is set aside for a depreciation reserve, and any part of the deduction in excess of the income set aside for the reserve shall be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the income set aside for the reserve) allocable to each. For example:

(1) If under the trust instrument or local law the income of a trust computed without regard to depreciation is to be distributed to a named beneficiary, the beneficiary is entitled to the deduction to the exclusion of the trustee.

(2) If under the trust instrument or local law the income of a trust is to be distributed to a named beneficiary, but the trustee is directed to maintain a reserve for depreciation in any amount the deduction is allowed to the trustee (except to the extent that income set aside for the reserve is less than the allowable deduction). The same result would follow if the trustee sets aside income for a depreciation reserve pursuant to discretionary authority to do so in the governing instrument.

No effect shall be given to any allocation of the depreciation deduction which gives any beneficiary or the trustee a share of such deduction greater than his pro rata share of the trust income, irrespective of any provisions in the trust instrument, except as otherwise provided in this paragraph when the trust instrument or local law requires or permits the trustee to maintain a reserve for depreciation.

(c) Estates. In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of income of the estate which is allocable to each.

2009 (7) (B) (a) ADDITIONAL FIRST-YEAR DEPRECIATION ALLOWANCE FOR SMALL BUSINESS.

M.S.A. 290.09, Subd. 7 (B) (a) provides that in the case of "Subd. 7 (B) property" the "reasonable allowance" as used in M.S.A. 290.09, Subd. 7 (A) (a), relating to the deduction for depreciation, may, at the election of the taxpayer, include an allowance of 20 percent of the cost (subject to certain limitations) of such property for the first taxable year for which a deduction is allowable under M.S.A. 290.09, Subd. 7 (A) (a) with respect to a taxable year beginning after December 31, 1958. For a definition of what constitutes "Subd. 7 (B) property" see M.S.A. 290.09, Subd. 7 (B) (d). The election under M.S.A. 290.09, Subd. 7 (B) (c) applies only to "Subd. 7 (B) property" to the extent the cost of such prop-

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erty for such taxable year does not exceed $10,000, or, in the case of a husband and wife filing a joint return for the taxable year, $20,000. The taxpayer shall select the cost (or fractional part of the cost) of one or more items of "Subd. 7 (B) property" qualifying for the election in the taxable year in an amount not in excess of the applicable limitation.

(b) Time And Manner Of Making Election. The election provided by M.S.A. 290.09, Subd. 7 (B) (c) with respect to "Subd. 7 (B) property" shall be made in a statement attached to the taxpayer's income tax return for the taxable year to which the election applies. The return and statement must be filed not later than the date prescribed by law for filing the return (including any extensions of time) for such taxable year. The statement shall indicate that the taxpayer has elected the provisions of M.S.A. 290.09, Subd. 7 (B) (a), and shall set forth the following information with respect to the property subject to the election.

(1) Description of property.

(2) Date property acquired.

(3) Estimated useful life at date of acquisition.

(4) How and from whom the property was acquired.

(5) Total cost of each item of property with respect to which election is made.

(6) Portion of cost of property selected. The selection made by the taxpayer with respect to such property shall be adhered to in computing the taxpayer's taxable income for the taxable year for which the selection is made, and for all subsequent taxable years.

(c) Consent To Revoke Election. An election made under M.S.A. 290.09, Subd. 7 (B) and this section with respect to any property shall be binding with respect to such property for the taxable year for which the election is made, and for all subsequent taxable years, unless consent to revoke the election is obtained from the Commissioner.

(d) Affiliated Group. Taxpayers which constitute an affiliated group as defined in M.S.A. 290.09 Subd. 7 (B) (d) (7) shall be treated as one taxpayer for the purpose of the limitation under M.S.A. 290.09, Subd. 7 (B) (b). In the case of an affiliated group the allowance for additional first-year depreciation may, in accordance with an agreement entered into by the members of the group, be taken by any one such member or divided among them in any portion. Any member of such group that is allowed any portion of the deduction under M.S.A. 290.09, Subd. 7 (B) shall file a statement in accordance with paragraph (b) of this section. Such statement shall include, in addition to the information required under paragraph (b) of this section, the names of the other

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members of the affiliated group and a description of the manner in which the deduction under M.S.A. 290.09, Subd. 7 (B) has been divided among them.

(e) Records. Any taxpayer who elects the additional allowance under M.S.A. 290.09, Subd. 7 (B) with respect to "Subd. 7 (B) property" shall reflect the adjustment to basis required by M.S.A. 290.09 Subd. 7 (B) (d) (8) in the records which he is required to keep under 2009 (7) (A) (a)-7.

2009 (8) DEPLETION.

(a) **Depletion defined.** Depletion is the exhaustion of natural resources such as mines, oil and gas wells, other natural deposits, and timber, through the consumption or use of such resources.

(b) **Depletion basis.** The capital sum recoverable through depletion allowances shall be determined by the basis specified in M.S.A. 290.14 and 290.15 for the purpose of computing the loss or gain on the sale or other disposition of property. In cases where a taxpayer uses a basis other than cost, the fair market value shall be determined by the Commissioner in accordance with the conditions known to exist on the valuation date, and when once established shall not be altered except in case of erroneous information or gross error.

(c) **Who is entitled to depletion.—**

Fee Owner Operator—In accordance with M.S.A. 290.05 (2) "corporations, individuals, estates and trusts engaged in the business of mining or producing iron ore" are exempt from the Act in so far as their income from these operations are concerned, and no value for depletion purposes need be ascertained in case of a fee owner operator.

Fee Owner Lessor—In cases where the owner in fee as of January 1, 1933, has leased mineral properties prior to that date, a value of these properties for depletion purposes shall be established on the basis of the income tax cost or the value as of that date of the royalties to be received; and in case of mineral properties leased after January 1, 1933, the value shall be based on the facts known to exist on January 1, 1933, with adjustments for ore removed or paid for subsequent to that date, with a waiting period from the basic date to the date of the lease.

Lessee Operator—In accordance with M.S.A. 290.05 (2) "corporations, individuals, estates and trusts engaged in the business of mining or producing iron ore" are exempt from the Act, in so far as their income from these operations are concerned, but this does not preclude the consideration of their interests in the valuation of the property for depletion purposes.

Lessee-Lessor—In cases where the lessee of mineral properties has re-leased the property to others prior to January 1, 1933,

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the value for depletion purposes shall be established in the same manner as for a fee owner lessor based on the amount of royalty to be received in excess of the amount of royalty to be paid on the entire property.

In the case of mineral properties leased after January 1, 1933, the value shall be based on the facts known to exist on January 1, 1933, with adjustments for ore removed or paid for subsequent to that date, with a waiting period from the basic date to the date of the lease.

In case of properties leased from the fee owner after January 1, 1933, and leased to others the value to the lessee-lessor shall be the cost.

The values of the equities of the lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(d) **Information required.** Form 137 is to be used to furnish information on which to base valuation calculations.

Annual information covering the amount of royalties received and the number of tons of ore paid for should accompany the return of each taxpayer claiming depletion.

(e) **Depletion deductions where units paid for in advance of extraction.** Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value established for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

If for any reason any such mineral lease shall be terminated or abandoned before the mineral which has been paid for in advance has been extracted and removed, and the lessor repossesses the leased property, the lessor shall adjust his capital accounts by restoring to the capital sum of the property the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and his income account shall be adjusted so as to include the amount so restored to capital sum as income of the year such lease is terminated or the property repossessed, and the tax thereon paid.

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Upon the expiration, termination, or abandonment of the lease, without the removal of any or all of the mineral contemplated by the lease, the lessor shall be required to restore to capital account the excess of the depletion theretofore allowable in respect of the royalty payments over the actual depletion or loss in value sustained as a result of the operations under the lease, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

(f) **Depletion of timber.** For the purpose of computing the allowance for depletion of timber for a given period, the number of units cut during the year shall be multiplied by the income tax cost per unit. To determine the unit cost, the taxpayer should ascertain:

(1) The income tax cost at the beginning of the period.

(2) Additions at cost during the period.

(3) The number of units on hand at the beginning of the taxable period, and

(4) The number of units acquired during the period.

Divide the sum of (1) and (2) by the sum of (3) and (4). The income tax cost means the basis as determined under M.S.A. 290.14 and 290.15 plus subsequent additions at cost, less depletion and cost or other basis of timber sold, deducted and allowed for income tax purposes to the beginning of the period under consideration.

If the taxpayer's estimate of the quality of timber known to have existed at the basic date subsequently is shown to be in error, a new estimate may be made, subject to the approval of the Commissioner, and such new estimate shall thereafter constitute the basis for the depletion deduction.

For the purpose of establishing the fair market value of timber as the basis for depletion deductions, careful consideration will be given to purchases and sales of similar property which were made within a reasonable period prior or subsequent to the basic date.

The term "basic date" means the date as of which valuation is determined.

Allowable depletion of timber may be deducted by the owner of the fee, or, in the case of leases, the deduction on a fee simple basis shall be equitably apportioned between the lessor and the lessee; where property is held in trust, the deduction shall be apportioned between the income beneficiaries, and the trustees in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. If the property is

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held by one person for life with remainder to another person, the life tenant shall be treated as the absolute owner for the purpose of the deduction for depletion.

Every taxpayer claiming a deduction for depletion of timber shall attach to his income tax return a map and statement for the taxable year covered by the return. The map shall show the timber and land acquired, timber cut, and timber and land sold. The statement shall contain the following information:

(1) Description of, cost of, terms of purchase or lease of timber and land acquired.

(2) Proof of profit or loss from sale of capital assets.

(3) Description of timber with respect to which claim for loss, if any, is made.

(4) Record of timber cut.

(5) Changes in each timber account as the result of purchase, sale, cutting, re-estimate, or loss.

(6) Changes in physical property accounts as the result of additions to or deductions from capital and depreciation.

(7) Operation data with respect to raw and finished material handled and inventoried.

(8) Unit production costs.

(9) Any other data which will be helpful in determining deductions claimed in the return.

2009 (10) Sickness and personal injury expenses paid.

The taxpayer is permitted to deduct from his gross income payments for hospitalization, nursing, medical, surgical, dental and other healing services, including institutional care and treatment for the mentally ill and physically handicapped and for medical supplies, ambulance hire and premiums paid for hospitalization insurance and medical service insurance for himself or his dependents during the taxable year.

There are four elements to consider:

(a) The payment of such sickness and personal injury expenses must be made during the taxable year.

(b) The payment must be for one of the specific purposes enumerated in the act.

(c) The deduction is limited to such expense paid for the taxpayer on his behalf or in behalf of his dependents.

(d) Traveling expenses do not constitute a proper deduction from gross income.

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If the expenses referred to above are incurred but not paid during the taxable year, no deduction can be taken. Thus, if an expenditure has been incurred in December, 1949, but not paid until January, 1950, no deduction can be taken until 1950. Deductible expenditures must be those which clearly come within the purposes enumerated in the Act.

The term "medical supplies" includes eye glasses, artificial limbs and teeth, hearing aids, braces, crutches, drugs, etc. Generally, a deduction for drugs is limited to prescriptions. Although there may be some exceptions to this rule, the burden is upon the taxpayer to prove the particular item or items represent drugs. The taxpayer must maintain a record of memorandum sufficient to substantiate such expenditures. A mere estimate of the amounts is not acceptable.

The names and addresses of the hospitals, doctors and dentists to whom payments were made must be included in the return.

The law exempts from income amounts received as compensation for personal injury or sickness. Therefore, the allowable deduction shall be deemed to be the amount of the expense incurred by the taxpayer for himself or his dependents reduced by the amount received during the taxable year in reimbursement for such expense.

If in a subsequent year the reimbursement is received, the amount of the reimbursement to the extent that the deduction reduced the tax liability in a prior year is included in gross income.

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2009 (16) CIRCULATION EXPENDITURES.

(a) Allowance Of Deduction. M.S.A. 290.09, Subd. 16 provides for the deduction from gross income of all expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical, subject to the following limitations:

(1) No deduction shall be allowed for expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical;

(2) The deduction shall be allowed only to the publisher making the circulation expenditures; and

(3) The deduction shall be allowed only for the taxable year in which such expenditures are paid or incurred. Subject to the provisions of paragraph (b) of this section, the deduction permitted under M.S.A. 290.09, Subd. 16 and this paragraph shall be allowed without regard to the method of accounting used by the taxpayer.

(b) Election To Capitalize. (1) A taxpayer entitled to the deduction for circulation expenditures provided in M.S.A. 290.09, Subd. 16 and paragraph (a) of this section may, in lieu of taking such deduction, elect to capitalize the portion of such circulation expenditures which is properly chargeable to capital account. As a general rule, expenditures normally made from year to year in an effort to maintain circulation are not properly chargeable to capital account; conversely, expenditures made in an effort to establish or to increase circulation are properly chargeable to capital account. For example, if a newspaper normally employs five persons to obtain renewals of subscriptions by telephone, the expenditures in connection therewith would not be properly chargeable to capital account. However, if such newspaper, in a special effort to increase its circulation, hires for a limited period 20 additional employees to obtain new subscriptions by means of telephone calls to the general public, the expenditures in connection therewith would be properly chargeable to capital account. If an election is made by a taxpayer to treat any portion of his circulation expenditures as chargeable to capital account, the election must apply to all such expenditures which are properly so chargeable. In such case, no deduction shall be allowed under M.S.A. 290.09, Subd. 16 for any such expenditures.

(2) A taxpayer may make the election referred to in subparagraph (1) of this paragraph by attaching a statement to his return for the first taxable year to which the election is applicable. Once an election is made, the taxpayer must continue in subsequent taxable years to charge to capital account all circulation expenditures properly so chargeable, unless the Commissioner, on application made to him in writing by the taxpayer,

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permits a revocation of such election for any subsequent taxable year or years. Permission to revoke such election may be granted subject to such conditions as the Commissioner deems necessary.

2009 (17) AMOUNTS REPRESENTING TAXES AND INTEREST PAID TO COOPERATIVE HOUSING CORPORATION.

(a) General Rule. A tenant-stockholder may deduct from his gross income amounts paid or accrued within his taxable year to a cooperative housing corporation representing certain taxes or interest paid or incurred by the corporation. Such amounts are not allowable as a deduction unless they represent the tenant-stockholder's proportionate share of—

(1) The real estate taxes allowable as a deduction to the corporation under M.S.A. 290.09, Subd. 4 which are paid or incurred by the corporation before the close of the taxable year of the tenant-stockholder on the houses (or apartment building) and the land on which the houses (or apartment building) are situated, or

(2) The interest allowable as a deduction to the corporation under M.S.A. 290.09, Subd. 3 which is paid or incurred by the corporation before the close of the taxable year of the tenant-stockholder on its indebtedness contracted in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses (or apartment building), or in the acquisition of the land on which the houses (or apartment building) are situated.

(b) Limitation. The deduction allowable under M.S.A. 290.09, Subd. 17 shall not exceed the amount of the tenant-stockholder's proportionate share of the taxes and interest described therein. In case a tenant-stockholder pays or incurs all or a part of his proportionate share of such taxes and interest to the corporation, the amount so paid or incurred which represents taxes and interest is allowable as a deduction if the requirements of M.S.A. 290.09, Subd. 17 are otherwise satisfied. As used in this section, the tenant-stockholder's proportionate share is that proportion which the stock of the cooperative housing corporation owned by the tenant-stockholder is of the total outstanding stock of the corporation, including any stock held by the corporation. If a tenant-stockholder pays or incurs to the corporation an amount on account of such taxes and interest and other items, such as maintenance, overhead expenses, and curtailment of mortgage indebtedness, the amount representing such taxes and interest is an amount which bears the same ratio to the total amount of the tenant-stockholder's payment or liability, as the case may be, as the total amount of the tenant-stockholder's proportionate share of such taxes and interest bears to the total amount of the tenant-stockholder's proportionate share of the taxes, interest, and other items on account of which such payment is made or liability incurred. No deduction is allowable under M.S.A. 290.09, Subd. 17

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for such part of amounts representing the taxes or interest described in that section as is deductible by a tenant-stockholder under any provision of Chapter 290.

(c) Cooperative Housing Corporation. (1) One Class of Stock. In order to qualify as a "cooperative housing corporation" under M.S.A. 290.09, Subd. 17, the corporation shall have one and only one class of stock outstanding. However, a special classification of preferred stock, in a nominal amount not exceeding $100, issued to a Federal housing agency or other governmental agency solely for the purpose of creating a security device on the mortgage indebtedness of the corporation, will not be considered as a "class of stock" within the meaning of M.S.A. 290.09.

(2) Right Of Occupancy. Each stockholder of the corporation must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by such corporation. The stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient. Such right must be conferred on each stockholder solely by reason of his ownership of stock in the corporation, that is, the stock must entitle the owner thereof either to occupy the premises or to a lease of the premises. The fact that the right to continue to occupy the premises is dependent upon the payment of charges to the corporation in the nature of rentals or assessments is immaterial.

(3) Distributions. None of the stockholders of the corporation may be entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the corporation, to receive any distribution other than out of earnings or profits of the corporation.

(4) Gross Income. It is a prerequisite to the allowance of a deduction under M.S.A. 290.09, Subd. 17 that at least 80 percent of the gross income of the corporation for the taxable year of the corporation in which the taxes and interest are paid or incurred is derived from tenant-stockholders.

(d) Tenant-stockholder. The term "tenant-stockholder" means an individual who is a stockholder in a cooperative housing corporation, as defined in M.S.A. 290.09, Subd. 17, and whose stock is fully paid up in an amount at least equal to an amount shown to the satisfaction of the commissioner as bearing a reasonable relationship to the portion of the fair market value, as of the date of the original issuance of the stock, of the corporation's equity in the building and the land on which it is situated which is attributable to the apartment or housing unit which such individual is entitled to occupy.

(e) Examples. The application of M.S.A. 290.09, Subd. 17 may be illustrated by the following examples, which refer to apartments but which are equally applicable to housing units:

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Example (1). The X Corporation is, and at all times since 1959 has been, a cooperative housing corporation within the meaning of M.S.A. 290.09, Subd. 17. In 1959 it purchased a site and constructed thereon a building with 10 apartments at a total cost of $200,000. The fair market value of the land and building was likewise $200,000 at the time of completion of the building. Each apartment is of equal value. Upon completion of the building, the X corporation mortgaged the land and the building for $100,000, and sold its total authorized capital stock consisting of 1,000 shares of common stock, for $100,000. The stock was purchased by 10 individuals, each of whom paid $10,000 for 100 shares. Each certificate for 100 shares provides that the holder thereof is entitled to a lease of a particular apartment in the building for a specified term of years. Each lease provides that the lessee shall pay his proportionate part of the corporation's expenses. In 1959 the original owner of 100 shares of the common stock of the X Corporation and of the lease to apartment No. 1 made a gift of the stock and lease to A, an individual. The taxable year of A and of the X Corporation is the calendar year. The corporation computes its taxable income on an accrual method, while A computes his taxable income on the cash receipts and disbursements method. In 1960 the X Corporation incurred expenses aggregating $13,800, namely, $4,000 for the real estate taxes on the land and building, $5,000 for the interest on the mortgage, $3,000 for the maintenance of the building, and $1,800 for other expenses. In 1961, A pays the X Corporation $1,380, representing his proportionate part of the expenses incurred by the corporation. The entire gross income of the X Corporation for 1960 was derived from tenant-stockholders. A is entitled under M.S.A. 290.09, Subd. 17 to a deduction of $900 in computing his taxable income for 1961.

The deduction is computed as follows:

Shares of stock of X Corporation owned by A		100
Shares of stock of X Corporation owned by 9 other tenant-stockholders		900
Total shares of stock of X Corporation outstanding		1,000
Proportion of outstanding stock of X Corporation owned by A		1/10
Expenses incurred by X Corporation:		
Real estate taxes	$4,000	
Interest	5,000	
Maintenance	3,000	
Other expenses	1,800	
		$13,800

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Amount paid by A representing his proportionate part of such expenses (1/10 of $13,800)	1,380
A's proportionate part of real estate taxes and interest based on his stock ownership (1/10 of $9,000)	900
A's proportionate part of total corporate expenses based on his stock ownership (1/10 of $13,800)	1,380
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,380)	900
A's allowable deduction	900

Since the stock which A acquired by gift was fully paid up by his donor in an amount equal to the portion of the fair market value, as of the date of the original issuance of the stock, of the corporation's equity in the land and building which is attributable to apartment No. 1, the requirement of M.S.A. 290.09, Subd. 17 in this regard is satisfied. The fair market value at the time of the gift of the corporation's equity attributable to the apartment is immaterial.

Example (2). The facts are the same as in example (1) except that the building constructed by the X Corporation contained, in addition to the 10 apartments, business space on the ground floor, which the corporation rented at $2,400 for the calendar year 1959. The corporation deducted the $2,400 from its expenses in determining the amount of the expenses to be prorated among its tenant-stockholders. The amount paid by A to the corporation in 1960 is $1,140 instead of $1,380. More than 80 percent of the gross income of the corporation for 1959 was derived from tenant-stockholders. A is entitled under M.S.A. 290.09, Subd. 17 to a deduction of $743.48 in computing his taxable income for 1959. The deduction is computed as follows:

Expenses incurred by X Corporation	$13,800.00
Less: Rent from business space	2,400.00
Expenses to be prorated among tenant-stockholders	11,400.00
Amount paid by A representing his proportionate part of such expenses (1/10 of $11,400)	1,140.00
A's proportionate part of real estate taxes and interest based on his stock ownership (1/10 of $9,000)	900.00

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A's proportionate part of total corporate expenses based on his stock ownership (1/10 of $13,800)	1,380.00
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,140)	743.48
A's allowable deduction	743.48

Since the portion of A's payment allocable to real estate taxes and interest is only $743.48, that amount instead of $900 is allowable as a deduction in computing A's taxable income for 1960.

Example (3). The facts are the same as in example (2) except that the amount paid by A to the X Corporation in 1960 is $1,000 instead of $1,140. A is entitled under M.S.A. 290.09, Subd. 17 to a deduction of $652.17 in computing his taxable income for 1960. The deduction is computed as follows:

Total amount paid by A	$ 1,000.00
A's proportionate part of real estate taxes and interest based on his stock ownership (1/10 of $9,000)	900.00
A's proportionate part of total corporate expenses based on his stock ownership (1/10 of $13,800)	1,380.00
Amount of A's payment representing real estate taxes and interest (900/1380 of $1,000)	652.17
A's allowable deduction	652.17

Since the portion of A's payment allocable to real estate taxes and interest is only $652.17, that amount instead of $900 is allowable as a deduction in computing A's taxable income for 1960.

2009 (22) SCHOOL TUITION AND TRANSPORTATION.

Subject to the following conditions, a deduction from gross income is allowed for amounts the taxpayer has paid to others during the taxable year for a dependent's tuition and the cost of transportation in attending an elementary or secondary school.

(a) **Elementary or secondary school.** The dependent (as defined below) must have been enrolled in an elementary or secondary school at the time the tuition expense or cost of transportation was incurred. An elementary or secondary school is defined as

(1) A kindergarten, grade, or high school in the Minnesota public school system; or

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(2) A school which is part of another public school system or which is non-public, provided that such school is equivalent to one of the schools referred to in (1), above, in both purpose and scope of instruction given. (But see the paragraph below regarding schools for the mentally retarded or physically impaired.)

(3) Limitation — The term "elementary or secondary school" does not include pre-kindergarten or post high school graduation grades.

If the dependent is mentally retarded or physically impaired, the cost of tuition and transportation of such dependent in receiving instruction in courses similar in content to courses taught in elementary or secondary schools for normal children is deductible. However, the cost of tuition and transportation expenses incurred to give such dependent other instruction, therapy, or medical care is not deductible under M.S.A. 290.09, Subd. 22. Any amounts deducted under M.S.A. 290.09, Subd. 10 cannot also be deducted under M.S.A. 290.09, Subd. 22.

(b) **Dependent defined.** A dependent for the purposes of this regulation is the same as a dependent for the purposes of M.S.A. 290.06, Subd. 3 (3). See Reg. 2006 (3) (b).

(c) **"In attending," defined.** For purposes of this regulation, "in attending an elementary or secondary school" means either

(1) physically attending an elementary or secondary school, or

(2) receiving instruction given by an elementary or secondary school to students who are unable to physically attend classes conducted at such school, or

(3) receiving instruction from a private teacher or school which is not an elementary or secondary school, provided that such instruction was acceptable for credit by the elementary or secondary school in which the dependent was enrolled.

No deduction is allowed for tuition or the cost of transportation paid to have a dependent receive instruction which is merely supplementary to class work taken by the dependent in his elementary or secondary school. Example: The taxpayer hires a private tutor to assist his son to receive a passing grade in the son's high school history class. Expenditures made to receive such instruction from the tutor are not deductible.

Amounts paid for the purpose of having the dependent attend extra curricular school activities such as sporting events, concerts, plays, dances, etc., are not deductible.

(d) **Tuition.** Tuition is defined as the charge made by an educational institution or individual to compensate such institu-

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tion or individual for instruction given or to be given to the dependent. Thus, tuition does not include charges made to compensate for feeding, lodging, or clothing of the dependent, nor does it include separate charges for the purchase or use of books, supplies, or equipment.

(e) **Cost of Transportation.** Unreimbursed amounts actually paid to a person or organization which provided the dependent with transportation in attending an elementary or secondary school are deductible. However, no deduction is permitted for any expense the taxpayer incurred in using his own car to provide such transportation for his dependent.

(f) **Limit on deduction.** The maximum amount a taxpayer may deduct for tuition and the cost of transportation for an individual dependent is limited to $200.00. If the amounts paid for an individual dependent total less than $200.00, the deduction with respect to such individual dependent is the total amount actually paid for such dependent.

(g) **Statement to be included in return.** The taxpayer must maintain a record or memorandum sufficient to substantiate the amounts claimed as tuition and transportation costs. A mere estimate of the amounts is not acceptable.

A statement must be included in the return listing, under the name of each dependent for whom the taxpayer paid tuition or transportation expenses, the following information:

(1) Amount paid for dependent's tuition and to whom paid.

(2) Amount paid for the dependent's transportation and to whom paid.

2009.5 (1) NET OPERATING LOSS—CORPORATIONS.

A net operating loss is sustained by a taxpayer in any taxable year beginning after December 31, 1944, if and to the extent that, for such year, there is an excess of deductions allowed by M.S.A. 290.09 over gross income, both computed with the following exceptions, additions and limitations:

(a) Deductions which are not attributable to the operation of a trade or business regularly carried on by the taxpayer are allowed only to the extent of the gross income not derived from such trade or business.

(b) There shall be included in computing gross income the amount of exempt interest decreased by the amount of interest paid or accrued to purchase or carry investments earning such interest.

(c) In the case of a taxpayer whose net income is subject to the allocation provisions of M.S.A. 290.19 the net operat-

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ing loss of such business is determined in the same manner as if the entire gross income were assignable to this State and the entire amount of the net operating loss is carried over as a deduction in computing net income.

(d) Losses connected with income producing activities the income from which is not required to be either assigned to this State or included in computing taxable net income are not allowed in computing a net operating loss. A net operating loss for a prior year is not allowed.

(e) Gains and losses from sales or exchanges of capital assets are taken into account without considering the special provisions of M.S.A. 290.16 which govern the treatment of capital gains and losses. In computing the net operating loss the amount deductible on account of capital losses may not exceed the amount includible on account of capital gains.

(f) Renegotiation of profits for a prior taxable year are not considered in computing a net operating loss.

(g) Federal income and excess profits taxes are not allowed.

(h) Contributions and other credits allowed under sections other than M.S.A. 290.09 are not allowed in computing the net operating loss.

(i) Gross income means the entire gross income whether or not assignable to Minnesota.

2009.5 (2) NET OPERATING LOSS CARRYOVER AND CARRYBACK—CORPORATIONS.

M.S.A. 290.095, allows as a deduction in computing taxable income the aggregate of the net operating loss carryover and net operating loss carryback to such taxable year. This deduction is referred to as the net operating loss deduction. The net operating loss is the basis for the computation of the net operating loss carryovers and net operating loss carrybacks, and ultimately, is the net operating loss deduction itself. The net operating loss deductions shall not be disallowed for any taxable year merely because the taxpayer has no income from a trade or business in the taxable year.

The net operating loss sustained in any taxable year ending in the year 1952 or any subsequent year, may be carried over to the five succeeding taxable years. The entire net operating loss may be carried over to the first succeeding taxable year; and the carryover to the succeeding taxable years is the excess of the net operating loss over the net income, if any, of the preceding taxable years computed with the exceptions, additions, and limitations provided in M.S.A. 290.095, Subd. 4(b) through (h).

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A net operating loss for any taxable year commencing prior to December 31, 1956 shall be computed under Minnesota Statutes 1953 section 290.095, but the amount so determined may be carried forward to each of the five taxable years following the year of such loss.

A net operating loss for any taxable year beginning on or after January 1, 1956, may be carried back to each of the three taxable years preceding the taxable year of such loss; however, in no event may a net operating loss be carried back to a taxable year commencing prior to December 31, 1956.

In order to compute the net operating loss deduction, the taxpayer must first determine the part of any net operating losses for preceding or succeeding taxable years which are carryovers or carrybacks to the taxable year in issue. The amount which is carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the taxable years preceding such taxable years to which it may be carried back or carried over. For the purpose of determining the taxable net income for such preceding taxable year, the various net operating loss carryovers and carrybacks to such taxable year are considered to be applied in reduction of the taxable net income in the order of the taxable years from which such loss is carried over or carried back, beginning with the loss for the earliest taxable year.

2009.5 (3) NET OPERATING LOSS DEDUCTION—CORPORATIONS.

The amount of the net operating loss allowed as a deduction in computing net income is the aggregate of the net operating loss carry-overs to the taxable year decreased by the amount by which the net income computed with the exceptions, additions and limitations provided in M.S.A. 290.095, Subd. 4 (b) through (h) exceeds the net income computed without such adjustments.

The application of this provision may be illustrated by the following example:

For the calendar year 1946 the taxpayer's taxable net income before deduction for net operating loss is $8,000. Federal income taxes paid of $1,200 were deducted as was a net capital loss of $2,000 representing a capital loss carry-over of $2,500 less 50% of a $1,000 long term gain realized in 1946. The taxpayer received exempt interest of $1,000 and paid $500 nondeductible interest to carry the investment. The aggregate of the net operating loss carry-overs is $7,000. The net operating loss carry-over for the year 1945 computed in Reg. 2009.5 (1) is $5,600. The net operating loss deduction for 1946 is $900 computed as follows:

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(1)	Net income for 1946 computed without adjustment		$8,000
	Add:		
(2)	Federal income taxes paid	$1,200	
(3)	Capital loss deducted	2,000	
(4)	Capital gain realized in 1946	1,000	
(5)	Exempt interest less interest paid to carry investment ($1,000 minus $500)	500	
(6)	Total adjustments		$4,700
(7)	Net income for 1946 computed with adjustments required by Subd. 3		$12,700
(8)	Excess of net income as adjusted over net income unadjusted (Item (7) minus Item (1))		4,700
(9)	Net operating loss carry-over		5,600
(10)	Net operating loss deduction (Item (9) minus Item (8))		900

2009.5 (4) COMPUTATION—EXCEPTIONS, ADDITIONS, LIMITATIONS.

(a) **Business carried on within and without Minnesota.** If a taxpayer's business is conducted partly within and partly without the State, and a net operating loss is sustained, such net operating loss is carried over and deducted in arriving at net income subject to allocation.

The amount by which Minnesota net income is reduced by reason of the net operating loss deduction may not exceed the amount of a net operating loss deduction determined to be from Minnesota sources. For this purpose a net operating loss is deemed to be from Minnesota sources to the extent that in the year sustained a net loss was assigned to Minnesota adjusted for the additions, limitations and exceptions enumerated in M.S.A. 290.095, Subd. 4.

The net operating loss of a taxpayer, who reports his income from his Minnesota operations on a separate accounting basis shall be computed with respect to the unit of business to which such separate accounting is applicable, subject to the additions, limitations and exceptions pertaining to that unit of business enumerated in M.S.A. 290.095, Subd. 4.

(b) **Joint return by husband and wife.** If a husband and wife making a joint return for any taxable year did not make

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a joint return for any of the taxable years involved in the computation of a net operating loss carry-over to the taxable year for which the joint return is made, such separate net operating loss carry-over is a joint net operating loss carry-over to such taxable year.

If a husband and wife making a joint return for a taxable year made a joint return for each of the taxable years involved in the computation of a net operating loss carry-over to such taxable year, the joint net operating loss carry-over to such taxable year is computed in the same manner as the net operating loss carry-over of an individual under the preceding regulations but upon the basis of the joint net operating losses and the combined net income of both spouses.

If a husband and wife making separate returns for a taxable year made a joint return for any or all of the taxable years involved in the computation of a net operating loss carry-over the separate net operating loss carry-over of each spouse to the taxable year is computed in the manner set forth in the preceding regulations but with the following exceptions and limitations:

(1) The net operating loss of each spouse for a taxable year for which a joint return was made shall be deemed to be the portion of the joint net operating loss attributable to the gross income and deductions of such spouse, both gross income and deductions being taken into account to the same extent that they are taken into account in computing the joint net operating loss.

(2) The net income of a particular spouse for any taxable year which is subtracted from the net operating loss of such spouse for another taxable year in order to determine the amount of such loss which may be carried over to still another taxable year is deemed to be, in a case in which such net income was reported in a joint return the sum of the following:

(a) The portion of the combined net income of both spouses for such year for which the joint return was made which is attributable to the gross income and deductions of the particular spouse, both gross income and deductions being taken into account to the same extent that they are taken into account in computing such combined net income, and

(b) The portion of such combined net income attributable to the other spouse, but if such other spouse has a taxable year beginning on the same date as the taxable year in which the particular spouse sustained the net operating loss from which the net income is subtracted, and if such other spouse sustained a net operating loss in such taxable year, then such portion shall first be reduced by such net operating loss of such other spouse. However, such net operating loss of such other

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spouse shall first be diminished by the excess, if any, of the reduction provided in M.S.A. 290.095, Subd. 3 for the year in which the net income was realized over the aggregate of the net operating loss carry-overs which are taken into account in computing the net operating loss deduction for such taxable year (see Clause (B) of the next sentence).

For the purpose of (a) and (b) above, the combined net income shall be computed as though the combined income and deductions of both spouses were those of one individual, and in such computation—

(A) The exceptions, additions, and limitations provided in M.S.A. 290.095, Subd. 4 shall apply, and

(B) The net operating loss deduction shall be determined without taking into account any net operating loss of either spouse or any joint net operating loss of both spouses which was sustained in a taxable year beginning on or after the date of the beginning of the taxable year in which the particular spouse sustained the net operating loss from which the net income is subtracted.

... [See M.S.A. 290.095, Subd. 6 concerning net operating loss carrybacks available to individuals, estates or trusts.]

2009.5 (7)-1 TENTATIVE CARRYBACK ADJUSTMENTS

(a) In General. Any corporation who has a net operating loss under M.S.A. 290.095 may file an application for a tentative carryback adjustment of the taxes for taxable years prior to the taxable year of the loss which are affected by the net operating loss carryback resulting from such loss.

(b) Contents of Application. (1) The application for tentative carryback adjustment shall be filed on Form 519. The application shall be filled out in accordance with the instructions on the form and all information required by the form must be furnished by the taxpayer.

An application for a tentative carryback adjustment does not constitute a claim for refund. If such application is disallowed by the Commissioner in whole or in part, no suit may be maintained in any court for the recovery of any tax based on such application. The filing of an application for a tentative carryback adjustment will not constitute the filing of a claim for refund within the meaning of M.S.A. 290.50 for purposes of determining whether a claim for refund was filed prior to the expiration of the applicable period of limitation. The taxpayer, however, may file a claim for refund under M.S.A. 290.50 at any time prior to the expiration of the applicable period of limitation,

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and may maintain a suit based on such claim if it is disallowed or if the Commissioner does not act on the claim within six months from the date it is filed. Such claim may be filed before, simultaneously with, or after the filing of an application for a tentative carryback adjustment. A claim for refund under M.S.A. 290.50 filed after the filing of an application for a tentative carryback adjustment is not to be considered an amendment of such application. Such claim, however, in proper cases may constitute an amendment to a prior claim filed under M.S.A. 290.50.

(c) Time and Place for Filing Application. The application for a tentative carryback adjustment shall be filed on or after the date of the filing of the return for the taxable year of the net operating loss and shall be filed within the period of twelve months from the end of such taxable year. Any application filed prior to the date the return for the taxable year of the loss is filed shall be considered to have been filed on the date such return is filed. Application shall be filed with the Commissioner of Taxation, St. Paul, Minnesota.

2009.5 (7)-2 COMPUTATION OF TENTATIVE CARRYBACK ADJUSTMENT

(a) Tax Previously Determined. The taxpayer is to determine the amount of decrease, attributable to the carryback, in tax previously determined for each taxable year before the taxable year of the net operating loss. Thus, the tax previously determined will be the tax shown on the return as filed, increased by any amounts assessed (or collected without assessment) as deficiencies before the date of the filing of the application for a tentative carryback adjustment, and decreased by any amounts abated, refunded, or otherwise repaid prior to such date. Any items as to which the Department of Taxation and the taxpayer are in disagreement at the time of filing of the application shall be taken into account in ascertaining the tax previously determined only if, and to the extent that, they were reported in the return, or were reflected in any amounts assessed (or collected without assessment) as deficiencies, or in any amounts abated, credited, refunded, or otherwise repaid, before the date of filing the application.

(b) Decrease Attributable to Carryback. The decrease in tax previously determined which is affected by the carryback or any related adjustments, is to be determined, except for such carryback and related adjustments, on the basis of the items which entered into the computation of such tax as previously determined; the tax previously determined being ascertained in the manner described in this regulation. In determining any such decrease, items shall be taken into account only to the extent that they were reported in the return, or were reflected in

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amounts assessed (or collected without assessment) as deficiencies, or in amounts abated, refunded, or otherwise repaid, before the date of filing the application for a tentative carryback adjustment. If the Department of Taxation and the taxpayer are in disagreement as to the proper treatment of any item, it shall be assumed for purposes of determining the decrease in tax previously determined that such item was correctly reported by the taxpayer unless, and to the extent that, the disagreement has resulted in the assessment of a deficiency (or the collection of an amount without an assessment), or the allowing or making of an abatement, refund, or other repayment, before the date of filing the application. Thus, if the taxpayer claimed a deduction on its return of $50,000 for salaries paid to its officers, but the Commissioner asserts that such deduction should not exceed $20,000, and the Department of Taxation and the taxpayer have not agreed on the amount properly deductible before the date the application for a tentative carryback adjustment is filed, $50,000 shall be considered as the amount properly deductible, for purposes of determining the decrease in tax previously determined in respect of the application for a tentative carryback adjustment. In determining the decrease in tax previously determined, any items, which are affected by the carryback must be adjusted to reflect such carryback.

2009.5 (7)-3 ALLOWANCE OF ADJUSTMENTS

(a) Time Prescribed. The Commissioner shall act upon any application for a tentative carryback adjustment filed, under M.S.A. 290.095, Subd. 7 within a period of 90 days from whichever of the following two dates is the later:

(1) The date the application is filed; or

(2) The last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss from which the carryback results.

(b) Examination. Within the 90-day period described in paragraph (a) of the regulation, the Commissioner shall make to the extent he deems practicable in such period, an examination of the application to discover omissions and errors of computation. He shall determine within such period the decrease in tax previously determined, affected by the carryback or any related adjustments, upon the basis of the application and such examination. The Commissioner, however, may correct any errors of computation or omissions he may discover upon examination of the application. In determining the decrease in tax previously determined which is affected by the carryback or any related

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adjustment, he accordingly may correct any mathematical error appearing on the application and he may likewise correct any modification required by the law and incorrectly made by the taxpayer in computing its net operating loss, the resulting carrybacks, or its net operating loss deduction. If the required modification has not been made by the taxpayer and the Commissioner has available the necessary information to make such modification within the 90-day period, he may in his discretion, make such modification. In determining such decrease, however, the Commissioner will not, for example, change the amount claimed on the return as a deduction for depreciation because he believes that the taxpayer has claimed an excessive amount; likewise he will not include in gross income any amount not so included by the taxpayer, even though the Commissioner believes that such amount is subject to tax and properly should be included in gross income.

(c) Disallowance in Whole or in Part. If the Commissioner finds that an application for a tentative carryback adjustment contains material omissions or errors of computation, he may disallow such application in whole or in part without further action. If, however, he deems that any error of computation can be corrected by him within the 90-day period, he may do so and allow the application in whole or in part. The Commissioner's determination as to whether he can correct any error of computation within the 90-day period shall be conclusive. Similarly, his action in disallowing, in whole or in part, any application for a tentative carryback adjustment shall be final and may not be challenged in any proceeding. The taxpayer in such case, however, may file a claim for credit or refund under M.S.A. 290.50, and may maintain a suit based on such claim if it is disallowed or if the Commissioner does not act upon the claim within six months from the date it is filed.

(d) Application of Decrease. (1) Each decrease determined by the Commissioner in any previously determined tax which is affected by the carryback or any related adjustments shall first be applied against any unpaid amount of the tax with respect to which such decrease was determined. Such unpaid amount of tax may include one or more of the following:

(i) An amount with respect to which the taxpayer is delinquent;

(ii) An amount the time for payment of which has been extended under M.S.A. 290.45, Subd. 2 and which is due and payable on or after the date of the allowance of the decrease; and

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(2) In case the unpaid amount of tax includes more than one of such amounts, the Commissioner, in his discretion, shall determine against which amount or amounts, and in what proportion, the decrease is to be applied. In general, however, the decrease will be applied against any amounts described in subparagraph (1) (i), and (ii) in the order named. The unpaid amount of tax against which a decrease may be applied under subparagraph (1) of this paragraph may not include any amount of tax for any taxable year other than the year of the decrease. After making such application, the Commissioner will credit any remainder of the decrease against any unsatisfied amount of tax for the taxable year of the net operating loss, which resulted in the carryback.

(3) Any remainder of the decrease after such application and credits may, within the 90-day period, in the discretion of the Commissioner, be credited against any tax or installment thereof then due from the taxpayer, and if not so credited, shall be refunded to the taxpayer within such 90-day period. For the purposes of refunding any such decrease or portion thereof, the overpayment of tax resulting from the carryback for purposes of this regulation shall be deemed not to have been made prior to the end of the taxable year, in which the net operating loss occurs.

2009.5 (7)-4 SPECIAL PERIOD OF LIMITATIONS WITH RESPECT TO NET OPERATING LOSS CARRYBACKS.

(a) (1) If the claim for refund relates to an overpayment of income tax attributable to a net operating loss carryback, provided in M.S.A. 290.095, Subd. 2, then in lieu of the period prescribed in M.S.A. 290.50, the claim may be filed, or refund allowed, as prescribed in M.S.A. 290.46 or 290.50 within either of the following 2 periods whichever is the later:

(i) The period which ends with the expiration of the fifteenth day of the forty-fifth month following the end of the taxable year of the net operating loss which resulted in the carryback; or

(ii) The period which ends with the expiration of the period prescribed in M.S.A. 290.46 or 290.50 within which a claim for refund may be filed with respect to the taxable year of the net operating loss which resulted in the carryback.

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(2) In the case of a claim for refund involving a net operating loss carryback described in subparagraph (1) of this paragraph, the amount of the refund may exceed the portion of the tax paid within the period provided in M.S.A. 290.50 to the extent of the amount of the overpayment attributable to the carryback. If the claim involves an overpayment based not only on a net operating loss carryback described in subparagraph (1) of this paragraph but based also on other items, the refund cannot exceed the sum of the following:

(i) The amount of the overpayment which is attributable to the net operating loss carryback, and

(ii) The balance of such overpayment up to a limit of the portion, if any, of the tax paid within the period provided in M.S.A. 290.50 or within the period provided in any other applicable provisions of law.

(3) If the claim involves an overpayment based not only on a net operating loss carryback described in subparagraph (1) of this paragraph but based also on other items, and if the claim with respect to any items is barred by the expiration of any applicable period of limitation, the portion of the overpayment attributable to the items not so barred shall be determined by treating the allowance of such items as the first adjustment to be made in computing such overpayment. If a claim for refund is not filed, and if refund is not allowed, within the period prescribed in this paragraph, then refund may be allowed or made only if claim therefor is filed, or if such refund is allowed, within the period prescribed in M.S.A. 290.46 or 290.50 subject to the provisions thereof limiting the amount of refund in the case of a claim filed, or if no claim was filed, in case of refund allowed, within such applicable period.

(b) If the allowance of a refund of an overpayment of tax attributable to a net operating loss carryback is otherwise prevented by the operation of any law or rule of law such refund may be allowed or made under the provisions of M.S.A. 290.095, Subd. 7 (c) if a claim therefor is filed within the period therein provided and paragraph (a) of this regulation for filing a claim for refund of an overpayment attributable to a carryback. Similarly, if the allowance of an application, or refund of a decrease in tax determined under M.S.A. 290.095, Subd. 7 (b) is otherwise prevented by the operation of any law or rule of law, such application, or refund may be allowed or made if an application for a tentative carryback adjustment is filed within the period provided in M.S.A. 290.095, Subd. 7 (a). Thus, for example, even though the tax liability (not including the net operating loss deduction or the effect of such deduction) for a given taxable year has previously been litigated before the Board of Tax

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Appeals, refund or an overpayment may be allowed or made if claim for such refund is filed within the period provided in M.S.A. 290.095, Subd. 7 (c) and paragraph (a) of this regulation. In the case of a claim for refund of an overpayment attributable to a carryback, or in the case of an application for a tentative carryback adjustment, the determination of any court, including the Board of Tax Appeals, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, to the extent that such deduction is affected by a carryback which was not in issue in such proceeding.

2009.5 (7)-5 AUDIT AND REVIEW.

The Commissioner in examining the books and records of the taxpayer relating to the income tax return for a taxable year, which except for the provisions of M.S.A. 290.095, Subd. 7 (c) would be outlawed by the normal limitation period, will limit such examination and consideration in accordance with the provisions of this regulation. The procedure outlined will be followed with respect to such returns in cases where either a claim for refund has been filed by the taxpayer or where an application for a tentative carryback adjustment has been filed. The Commissioner will make appropriate adjustments as a result of such examination up to the amount of the tentative adjustment or the amount of the carryback but will in no event assess additional taxes for the year of carryback.

In the event that such examination discloses that the amount refunded to the taxpayer pursuant to application under M.S.A. 290.095, Subd. 7 (a) was improper, the Commissioner shall issue his order assessing a tax which assessment shall in no event exceed the amount of the erroneous refund made for the year in question. Such assessment shall be made in accordance with the provisions of M.S.A. 290.46, and the provisions of Chapter 290, dealing with notice, appeal, and collection, applicable to 290.46 assessments shall be equally applicable to assessments under this regulation.

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2010 (1) PERSONAL AND FAMILY EXPENSES.

As a general rule, personal, living or family expenses do not constitute a proper deduction from gross income. This rule is modified by the provisions of M.S.A. 290.09 which specifically permits the deduction of certain personal expenses such as interest, taxes, losses, bad debts, contributions and sickness and personal injury expenses. Reference should be made to that section for the determination of the deductibility of any particular item. The following are classified as nondeductible items under M.S.A. 290.10:

Premiums paid on any life insurance policy covering the life of the taxpayer or any other person.

Insurance paid on a dwelling owned and occupied by the taxpayer.

Payment for funeral expenses.

Expenses of education, except as provided in Reg. 2009 (2)-5.

Allowances given to minor children by their parents in consideration of services if the parents were entitled to such services.

An amount allowed a wife by a husband as compensation for acting as housewife.

Sums paid to a wife under terms of a marriage agreement.

Payments as damages for breach of promise to marry.

Payments for alienation of affections.

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Alimony, separate maintenance, and support payments except as provided in M.S.A. 290.072.

The cost of board and wages of a housekeeper.

Taxes if paid by a person other than the person upon whom the tax was imposed. Penalties paid with respect to State or Federal income taxes. (For other nondeductible taxes, see M.S.A. 290.09, Subd. 4 and Reg. 2009 (4).)

Expenses in going to and from one's place of employment or expenses to seek employment. However, fees paid to an employment agency are deductible.

The non-business portion of the upkeep and operating expense of an automobile.

Loss on the sale of pleasure automobiles.

Loss on sale of social club memberships.

Fees paid by an individual for general personal legal services.

Attorney's fees in connection with foreclosure proceedings.

Commissions paid on mortgage renewals.

The cost of preparing an abstract in case of a sale of capital assets.

Expenses paid for a legatee to sustain or attack the validity of a will.

The cost of hunting, fishing and dog licenses.

The value of house rent of a home occupied by the taxpayer, or the amount paid for the rent of a home.

In the case of a professional man who rents a property for residential purposes but incidentally receives clients, patients or callers there, in connection with his professional work (his place of business being elsewhere) no part of the rent is deductible as a business expense. If, however, he uses part of the house for an office such portion of the rent as is properly attributable to such office is deductible.

For treatment of amounts paid into pension or retirement funds, see Reg. 2010 (8).

2010 (2) NON-DEDUCTIBLE ITEMS, CAPITAL EXPENDITURES.

Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction had been made) of property are not deductible from gross income.

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Amounts expended for securing a copyright and plates which remain the property of the person making the payments are investments of capital.

The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense.

Legal expenses incurred in foreclosing a mortgage are not deductible; they should be added to the cost of the investment.

Commissions and legal fees paid by a lessor to secure a long-term lease are capital expenditures to be spread ratably over the term of the lease.

Amounts paid for buildings or permanent improvements which increase the value of any property or estate are capital expenditures. (But see M.S.A. 290.09, Subd. 21 for treatment of soil or water conservation expenditures.)

The excess cost of remodeling a building over the actual value of improvements when completed is a capital expenditure.

The cost of extensive alterations to buildings representing unusual and extraordinary expense is not deductible in any single year but should be added to the purchase price of the property and subjected to depreciation deductions.

The amounts expended for replacements or renewals of a permanent nature should be charged directly to the property account or to the depreciation reserve account depending upon the method of treating depreciation charges in the books of accounts.

Expenditures for the services of an architect are part of the cost of the building.

Insurance premiums and other expenses paid during building operations are capital expenditures.

Delinquent taxes, insurance and other expenses paid by a mortgagee prior to foreclosure represent an additional loan on the property.

Delinquent taxes, insurance and other expenses paid by a mortgagee after foreclosure represent an additional investment in the property.

Development expenses incurred in connection with developing mineral deposits are treated as capital expenditures and they should be added to the cost of the property and made subject to depreciation.

For treatment of expenditures for research and experimentation, see M.S.A. 290.09, Subd. 18.

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The amount expended in prosecuting litigation in connection with patent infringements after the patent has been issued is deductible as an expense in the year paid or accrued.

For treatment of expenses of organizing a corporation, see M.S.A. 290.09, Subd. 19.

Other than as specified in preceding regulations, there will not be allowed as deductions from gross income, any amounts added to a reserve account by whatever nature they are called.

Amounts to be assessed and paid under an agreement by the bondholder or shareholder of a corporation to be used in reorganization of the corporation are investments of capital and not deductible for any purpose in returns of income.

Assessments on bank stock paid by the stockholders are not deductible until the stock is disposed of or becomes worthless.

Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, reduce the selling price.

Commissions paid in purchasing securities are part of the cost price of such securities.

A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and to increase the value of its stockholdings in the subsidiary may not deduct amounts paid in carrying out this guarantee in computing its net income but such payments may be added to the cost of its stock in the subsidiary.

2010 (6) LOSSES FROM SALES BETWEEN MEMBERS OF FAMILIES AND BETWEEN INDIVIDUALS AND CORPORATIONS.

Under M.S.A. 290.10 (6) no losses are deductible from gross income unless the taxpayer shows to the satisfaction of the Commissioner that the sale or exchange was bona fide and for a fair and adequate consideration.

Under no circumstances will losses of this nature be allowed on sales or exchanges for less than the fair market value of the property on the date of the transaction.

2010 (7) DISALLOWANCE OF DEDUCTIONS FOR UNPAID EXPENSES AND INTEREST.

The application of M.S.A. 290.10 (7) may be illustrated by the following example:

A is the holder and owner of an interest-bearing note executed by the M Corporation all of the stock of which is owned

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by him. A and the M Corporation make their income returns on the basis of a calendar year but the M Corporation makes its returns on the accrual basis and A makes his returns on the cash receipts and disbursements basis. The M Corporation does not pay any interest on such note during the calendar year 1939 or within two and one-half months after the close thereof, but claims a deduction for the year 1939 with respect to the interest accruing on the note in that year. A, being on the cash receipts and disbursements basis, does not include such interest in his return for the year 1939. By the application of M.S.A. 290.10 (7) no deduction for such interest is allowable in computing the net income of the M Corporation for the year 1939. The provisions of M.S.A. 290.10 (7) do not otherwise affect the general rules governing the allowance of deductions under the accrual basis. Hence, in the event the M Corporation should pay such interest after March 15, 1940, no deduction therefor would be allowable in computing its net income for the year in which the payment was made.

However, the provisions of M.S.A. 290.10 (7) are applicable only to those taxpayers who come within the purview of M.S.A. 290.10 (6).

Accordingly, the provisions of M.S.A. 290.10 (7) are applicable only if the following three conditions precedent are present:

(1) If such expenses or interest are not paid within the taxable year or within two and one-half months after the close thereof; and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under M.S.A. 290.10 (6).

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2010 (9) NONDEDUCTIBLE EXPENSES, INTEREST, AND TAXES.

No deduction from gross income shall be allowed for expenses, interest, and taxes connected with or allocable against the production or receipt of all income not included in the measure of the tax imposed by this Act. The phrase, "income *** included in the measure of the tax," as used in M.S.A. 290.10 (9) does not refer to the net or dollar volume income actually taxed by the State but to the class or classes of income subject to taxation. For example, no deduction is permitted for expenses paid or incurred in the production or collection of interest income if such interest income is of a type which is excluded from gross income under M.S.A. 290.08. If an item of expense, interest, or taxes is attributable partly to a class of income which is taxable under this Act and partly to a class of income which is not taxable under this Act, a deduction is permitted only for the portion of such expense, interest, or tax which is reasonably apportionable, in the light of all the facts and circumstances, to the class of income which is taxable under this Act. See also M.S.A. 290.17 (allocation of gross income to State), and M.S.A. 290.18 (computation of taxable net income and adjusted gross income) and the regulations thereunder.

The total amount of Federal income taxes paid is not deductible if:

(1) a class of income included in the Federal return is not included in the measure of the tax under this Act (see preceding paragraph);

(2) all or a portion of the income included in the Federal return is not assignable to this State (see M.S.A. 290.18 and the regulations thereunder).

If the husband and wife file a joint Federal return and separate Minnesota returns, a deduction for Federal income taxes paid is allowed provided:

(1) the spouse claiming the deduction paid the tax during the year for which the deduction is claimed, and

(2) such spouse was liable for the tax.

In cases where Federal income taxes are paid out of joint bank accounts or joint funds, the tax shall be considered as having been paid by either spouse. Amounts withheld for payment of Federal income taxes shall be considered payments made by the spouse from whom the amount was withheld.

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2010(10) TAXES AND CARRYING CHARGES CHARGEABLE TO CAPITAL ACCOUNT AND TREATED AS CAPITAL ITEMS.

(a) In General. In accordance with Section 290.10(10), items enumerated in paragraph (b)(1) of this regulation may be capitalized at the election of the taxpayer. Thus, taxes and carrying charges with respect to property of the type described in this regulation are chargeable to capital account at the election of the taxpayer, notwithstanding that they are otherwise expressly deductible under provisions of Chapter 290. No deduction is allowable for any items so treated.

(b) Taxes and Carrying Charges. (1) The taxpayer may elect, as provided in paragraph (c) of this regulation, to treat the items enumerated in this subparagraph which are otherwise expressly deductible under the provisions of Chapter 290 as chargeable to capital account either as a component of original cost or other basis, for the purposes of Sections 290.14 and 290.15. The items thus chargeable to capital account are—

(i) In the case of unimproved and unproductive real property: Annual taxes, interest on a mortgage, and other carrying charges.

(ii) In the case of real property, whether improved or unimproved and whether productive or unproductive:

(a) Interest on a loan (but not theoretical interest of a taxpayer using his own funds),

(b) Taxes of the owner of such real property measured by compensation paid to his employees,

(c) Taxes of such owner imposed on the purchase of materials, or on the storage, use, or other consumption of materials, and

(d) Other necessary expenditures, paid or incurred for the development of the real property or for the construction of an improvement or additional improvement to such real property, up to the time the development or construction work has been completed. The development or construction work with respect to which such items are incurred may relate to unimproved and unproductive real estate whether the construction work will make the property productive of income subject to tax (as in the case of a factory) or not (as in the case of a personal residence), or may relate to property already improved or productive (as in the case of a plant addition or improvement, such as the construction of another floor on a factory or the installation of insulation therein).

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(iii) In the case of personal property:

(a) Taxes of an employer measured by compensation for services rendered in transporting machinery or other fixed assets to the plant or installing them therein,

(b) Interest on a loan to purchase such property or to pay for transporting or installing the same, and

(c) Taxes of the owner thereof imposed on the purchase of such property or on the storage, use, or other consumption of such property,

paid or incurred up to the date of installation or the date when such property is first put into use by the taxpayer, whichever date is later.

(iv) Any other taxes and carrying charges with respect to property, otherwise deductible, which in the opinion of the Commissioner are, under sound accounting principles, chargeable to capital account.

(2) The sole effect of Section 290.10(10) is to permit the items enumerated in subparagraph (1) of this paragraph to be chargeable to capital account notwithstanding that such items are otherwise expressly deductible under the provisions of Chapter 290. An item not otherwise deductible may not be capitalized under Section 290.10(10).

(3) On the absence of a provision in this regulation for treating a given item as a capital item, this regulation has no effect on the treatment otherwise accorded such item. Thus, items which are otherwise deductible are deductible notwithstanding the provisions of this regulation, and items which are otherwise treated as capital items are to be so treated. Similarly, an item not otherwise deductible is not made deductible by this regulation. Nor is the absence of a provision in this regulation for treating a given item as a capital item to be construed as withdrawing or modifying the right now given to the taxpayer under any other provisions of Chapter 290, or of the regulations thereunder, to elect to capitalize or to deduct a given item.

(c) Election to Charge Taxes and Carrying Charges to Capital Account. (1) If for any taxable year there are two or more items of the type described in paragraph (b)(1) of this regulation, which relates to the same project to which the election is applicable, the taxpayer may elect to capitalize any one or more of such items even though he does not elect to capitalize the remaining items or to capitalize items of the same type relating to other projects. However, if expenditures for several items of the same type are incurred with respect to a single project, the election to capitalize must, if exercised, be exercised as to all items of that type. For purposes of this regulation, a "project"

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means, in the case of items described in paragraph (b) (1) (ii) of this regulation, a particular development of, or construction of an improvement to, real property, and in the case of items described in paragraph (b) (1) (iii) of this regulation, the transportation and installation of machinery or other fixed assets.

(2) (i) An election with respect to an item described in paragraph (b) (1) (i) of this regulation is effective only for the year for which it is made.

(ii) An election with respect to an item described in—

(a) Paragraph (b) (1) (ii) of this regulation is effective until the development or construction work described in that paragraph has been completed;

(b) Paragraph (b) (1) (iii) of this regulation is effective until the later of either the date of installation of the property described in that paragraph, or the date when such property is first put into use by the taxpayer;

(c) Paragraph (b) (1) (iv) of this regulation is effective as determined by the Commissioner.

Thus, an item chargeable to capital account under this regulation must continue to be capitalized for the entire period described in the paragraph applicable to such election although such period may consist of more than one taxable year.

(3) If the taxpayer elects to capitalize an item or items under this regulation, such election shall be exercised by filing with the original return for the year for which the election is made a statement indicating the item or items (whether with respect to the same project or to different projects) which the taxpayer elects to treat as chargeable to capital account. Elections filed for taxable years beginning after December 31, 1960 and prior to January 1, 1965, shall be filed not later than July 15, 1966.

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2011 (1) WHEN INVENTORIES ARE REQUIRED.

Inventories are necessary in order to properly reflect the net income in every case in which the production, purchase, or sale of merchandise is an income producing factor. All raw materials and supplies which will physically become a part of merchandise intended for sale, and all finished or partly finished goods which have been produced or acquired for sale, should be included in the inventory. Supplies of the type which are consumed as an incident to the conduct of business should not be included with the other merchandise in the inventory. Only merchandise title to which is vested in the taxpayer should be included in the inventory. The seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract, and goods out upon consignment, but should exclude from inventory goods sold, title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased, title to which is passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should exclude goods ordered for future delivery, the title to which has not been transferred.

2011 (2) VALUATION OF INVENTORIES.

An inventory valued in accordance with the best accounting practice in the trade or business and used by the taxpayer to show his financial position, can usually be accepted for tax purposes. No inventory practice will be considered as clearly reflecting the taxable income which is not consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation, provided that the method or basis used is substantially in accord with these regulations.

The bases most commonly used in valuing inventories are (1) cost, and (2) cost or market, whichever is lower. When the inventory includes goods which are unsalable at normal prices or cannot be used for the purpose for which they were acquired, because of damage, imperfection, shop wear, change of style, odd or broken lots, or other similar causes, such goods should be valued at bona fide selling prices less costs. In the case of dam-

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age or imperfect raw materials or work in process, the basis of valuation must take into consideration the usability and condition of the goods, but in no case shall the value be less than scrap value. Bona fide selling price means the price at which the goods are offered for sale at or about the date of the inventory. The burden of proof will rest upon the taxpayer to show that the portions of the inventory in question were actually offered for sale at or about the date of the inventory, and to maintain adequate records of the disposition of the goods which will permit a verification of the inventory.

Whether the cost, or cost or market whichever is lower, basis of valuing inventories is used, the basis adopted must be applied with reasonable consistency to the entire inventory, and no change from one basis to the other will be permitted without first obtaining permission from the Commissioner.

Goods included in the inventory which have become so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased or produced and the cost thereof will be the actual cost of goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired.

When the system of accounting involves the keeping of perpetual inventory records, actual physical inventories must be taken at reasonable intervals and proper adjustments made to bring the books into accord with such physical inventories.

Inventories should be preserved as a part of the accounting records of the taxpayer in such a manner as to set forth clearly the number of units, prices and extensions. Suitable summaries should be preserved, showing the totals by classes or departments of the goods included in the inventory. The inventory records will be subject to investigation by the Commissioner and the taxpayer must, therefore, preserve such data as will be necessary to substantiate the correctness of the quantities and prices included therein.

2011 (3) INVENTORY VALUATION METHODS NOT PERMITTED.

The following methods, among others, are sometimes used in the valuation of inventories, but are not permitted for income tax purposes:

(1) Deducting reserves for anticipated price changes or estimated depreciation from the gross inventory.

(2) Using a constant valuation from year to year for a so-called normal quantity of materials or goods on hand.

(3) Excluding goods out on consignment from the inventory.

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(4) Including in the inventory goods ordered, but the title to which has not been acquired.

(5) Valuing work in process at less than its proper value.

2011 (4) INVENTORIES AT COST.

Within the meaning of the regulations on M.S.A. 290.11, "cost" means, in the case of merchandise on hand at the beginning of the taxable year or purchased during the taxable year, the invoice price less trade or other discounts, except cash discounts. Cash discounts are distinguished by being comparatively small in amount, usually approximating a fair interest rate and usually contingent upon prompt payment. Cash discounts may or may not be deducted from the invoice price, at the option of the taxpayer, provided a consistent practice is followed. Transportation or other necessary charges incurred in acquiring possession of the goods must be added to the net invoice price.

In the case of merchandise produced by the taxpayer since the beginning of the taxable year, "cost" means (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, and (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with the established trade practice in the particular industry. Among such are (a) farmers and raisers of live stock, (b) miners and manufacturers, who, by a single process or series of processes, derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and (c) retail merchants who use what is known as the "retail method" in ascertaining approximate cost.

2011 (5) INVENTORIES AT COST OR MARKET, WHICHEVER IS LOWER.

Under ordinary circumstances and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the following cases: (a) of goods purchased and on hand; and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of

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manufacture for delivery upon firm sales contract (i.e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost.

Where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sale of the taxpayer for a reasonable period before and after the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

2011 (6) INVENTORIES BY DEALERS IN SECURITIES.

A dealer in securities who in his books of account regularly inventories unsold securities on hand either:

(a) At cost;

(b) At cost or market, whichever is lower; or

(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another method be authorized by the Commissioner pursuant to a written application therefor filed with the taxpayer's return. A dealer in securities in whose books of account separate computations of the gain or loss from the sale of various lots of securities sold are made on the basis of the cost of each lot shall be regarded, for the purpose of this regulation, as regularly inventorying his securities at cost. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to

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customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

2011 (7) INVENTORIES OF MINERS AND MANUFACTURERS.

A taxpayer engaged in mining or manufacturing who, by a single process or uniform series of processes, derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of different kinds of products.

2011 (8) INVENTORIES OF RETAIL MERCHANTS.

Retail merchants who employ what is known as the "retail method" of pricing inventories may make their return upon that basis, provided that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to, unless a change is authorized by the Commissioner. Under this method the goods in the inventory are ordinarily priced at the selling prices, and the total retail value of the goods in each department or of each class of goods is reduced to approximate cost by deducting the percentage which represents the difference between the retail selling value and the purchase price. This percentage is determined by departments of a store or by classes of goods, and should represent as accurately as possible the amounts added to the cost prices of the goods to cover selling and other expenses of doing business and the margin of profit. In computing the percentage above mentioned, proper adjustment must be made for all mark-ups and mark-downs.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of profit based

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upon an average of his entire business, but should compute and use in valuing his inventory the proper percentage for the respective departments or classes of goods.

A physical inventory at retail selling price, reduced by mark-ups, must be taken at the close of each year and the book inventory must be adjusted to agree with the physical inventory. If the mark-up in the opening inventory is different from the mark-up of current purchases, the latter mark-up should be used in closing inventory, unless substantial quantities of year-old merchandise appear in the closing inventory.

The books and records must be fully departmentalized so that merchandise with a similar percentage of mark-up is accounted for separately in the inventory.

The difference between the inventory taken on the old basis and the inventory taken on the basis of the "retail method" will constitute taxable income or deductible expense for the year in which the change is made. Any gross discrepancies between the new and old basis will be taken as an indication either that the inventory was improperly taken on the old basis or that the inventory upon the basis of the "retail method" does not reflect values which will properly account for the true taxable income.

2011 (9) INVENTORIES OF DEALERS IN REAL ESTATE.

Real estate held by dealers in real estate must be carried at cost value and, therefore, cannot be included in inventories which are subject to valuation at cost or market, whichever is lower. Any increase or decrease in the market value of real estate held will not constitute a taxable gain or deductible loss until realized or sustained through sale or other disposition.

2011 (10) INVENTORIES OF LUMBER COMPANIES.

The inventories of lumber companies shall be valued according to the general rules of cost or cost or market, whichever is lower. In order to determine the market value of goods in process and finished goods, such inventories must be analyzed as to their basic elements of cost, which include material, labor, and overhead. The purchase market of each of the basic elements of cost should be determined and the total thereof taken as the market. If the market thus determined is less than cost, the inventory should be valued upon that basis.

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2012 (2) ADJUSTMENTS.

(a) **In general.** The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to the capital account, including the cost of improvements and betterments made to the property. Carrying charges, such as taxes and interest, are not properly chargeable to the capital account even though they have not been taken as a deduction by the taxpayer and even though they were incurred on unimproved and unproductive real property.

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion allowed or allowable under the Minnesota Income Tax Act. Such amount shall not be less than the amount allowable. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the facts known at the time. In addition, if the property was acquired before January 1, 1933, the basis (if other than the fair market value as of January 1, 1933) shall be diminished by the depreciation actually sustained before January 1, 1933. For example, if a taxpayer sells non-income producing property such as his residence which has not been subject to the depreciation allowance under the Minnesota Income Tax Act, the basis need not be diminished because of the depreciation sustained after January 1, 1933. However, the basis must be diminished for depreciation actually sustained prior to January 1, 1933.

If a person or organization was not subject to taxation under the Minnesota Income Tax Act during some period after December 31, 1932, but subsequently became subject to taxation, such person or organization must adjust the cost or other basis of its property for the exhaustion, wear and tear, obsolescence, amortization, and depletion actually sustained during the period it was not subject to taxation. This requirement applies to all taxable years beginning after December 31, 1954. If such person or organization acquired property prior to January 1, 1933, the basis of such property (if the basis is other than fair market value as of January 1, 1933) must also be adjusted for depreciation, etc., actually sustained during the period beginning on the date of acquisition of the property and ending December 31, 1932.

In the case of the stock of a subsidiary company, the basis thereof must be adjusted for the amount of the subsidiary com-

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pany's loss for the years in which consolidated returns were made.

(b) **Period for which adjustments are applicable.** If, in accordance with the provisions of M.S.A. 290.14 and 290.15, the basis used is the cost of the property, then such basis must be adjusted as provided in M.S.A. 290.12, Subd. 2, for the period from the date of purchase (by the taxpayer or otherwise) to the date of sale or other disposition.

However, if the basis used is the fair market value of the property as of a certain date (as provided in M.S.A. 290.14 and 290.15), then such adjustments must be made only from the date for which the fair market value was determined to the date of sale or other disposition.

These rules are applied in the following example:

A realizes a gain on disposition of property in 1940 which he acquired by gift from B in 1930. B had paid $2,000.00 for the property in January, 1925. A, in computing the gain realized, elects to use cost as the basis. Under the provisions of M.S.A. 290.15 the amount B paid for the property in 1925 is deemed to be A's cost, and, therefore, such cost must be adjusted as provided in this regulation from January, 1925, to the date of sale. If A had elected or was required under the provisions of M.S.A. 290.14 and 290.15 to use as a basis the fair market value of the property as of January 1, 1933, or other date, then the adjustments are applicable only from such date to the date of sale or other disposition.

(c) **Reduction in basis of new residence.** A reduction of the basis of a new residence shall be made, where the purchase of a new residence results, under M.S.A. 290.13, in the non-recognition of any part of the gain realized upon the sale of an old residence. The adjustment to basis shall include a reduction by an amount equal to the amount of the gain which was not recognized upon the sale of the old residence. Such a reduction is not to be made for the purpose of determining the adjusted basis of the new residence as of any time preceding the sale of the old residence. For the purpose of this determination, the amount of the gain not recognized under this regulation upon the sale of the old residence includes only so much of the gain as is not recognized because of the taxpayer's cost, up to the date of the determination of the adjusted basis, of purchasing the new residence.

For example: On January 1, 1953, the taxpayer buys a new residence for $10,000. On March 1, 1953, he sells for $15,000 his old residence which has an adjusted basis to him of $5,000. During April a wing is constructed on the new house at a cost of $5,000 and in May he builds a garage at a cost of $2,000. The basis of the new residence during January and February is

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the cost of $10,000. This basis is reduced to $5,000 on March 1. This reduced basis represents the difference between the cost of $10,000 and $5,000 which is the portion of the gain which at this point has been re-invested in the new residence. The adjusted basis during April remains $5,000, because the additional investment of $5,000 in the improvement to the new residence offsets the remaining $5,000 of the gain. The basis during May and the following months is increased to $7,000 by the investment of $2,000 in the garage.

(d) **Adjustments where property is acquired by exchange and wash sale transactions.** In the case of the sale or other disposition of property acquired in an exchange of the kind specified in M.S.A. 290.13, Subd. 1, the adjustments to the basis as provided in M.S.A. 290.12, Subd. 2, must be made to the extent to which the taxpayer would be required to make them were he selling or otherwise disposing of the property exchanged in any such transaction.

(e) **Gain realized in cases where property is not sold or disposed of.** Even though property is not sold or otherwise disposed of, gain (includible in gross income under M.S.A. 290.01, Subd. 20) is realized if the sum of all the amounts received which are required by this regulation to be applied against the basis of the property exceeds such basis. Such amounts must be included in gross income to the extent that the basis is exceeded in the year received.

2013 (1) TRANSACTIONS IN WHICH NO GAIN OR LOSS IS RECOGNIZED.

(a) **Property held for productive use in trade or business or for investment.** As used in M.S.A. 290.13 (1), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class without recognition of gain or loss. The fact that any real estate involved is improved or unimproved is not material, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

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No gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose, or (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or improved real estate for unimproved real estate, or (3) a taxpayer exchanges investment property and cash for investment property.

Gain or loss is recognized if the taxpayer exchanges (1) Fourth Liberty Loan 4½ percent bonds for new Treasury bonds maturing October 15, 1945, or (2) a real estate mortgage for bonds of the Home Owners' Loan Corporation.

(b) Stock for stock of the same corporation. The exchange, without the recognition of gain or loss, of common stock for common stock, or of preferred stock in the same corporation is not limited to a transaction between a stockholder and the corporation; it includes an exchange between two individual stockholders. However, gain or loss will be recognized if stock is exchanged for bonds, or preferred stock is exchanged for common stock or common stock is exchanged for preferred stock in the same corporation unless the exchange is made in connection with a "reorganization." If a taxpayer exchanges common stock in one corporation for common stock in another corporation, gain or loss is recognized unless the exchange is made in connection with a "reorganization."

2013 (2) RECEIPT OF OTHER PROPERTY OR MONEY IN TAX-FREE EXCHANGE NOT CONNECTED WITH CORPORATE REORGANIZATION.

If in any transaction in which (a) property held for investment or productive use in trade or business is exchanged for property of like kind to be held either for productive use or for investment; or (b) common stock is exchanged for common stock, or preferred stock for preferred stock in the same corporation and not in connection with a corporate reorganization; there is received by the taxpayer other property (in addition to property permitted to be received without recognition of gain) or money, then:

(1) The gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of the money and the fair market value of other property; but

(2) No loss from such an exchange will be recognized in any case. (M.S.A. 290.13, Subd. 2.)

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2013 (5)-1 INVOLUNTARY CONVERSION: NONRECOGNITION OF GAIN.

In general. M.S.A. 290.13, Subd. 5 applies to cases where property is compulsorily or involuntarily converted. An "involuntary conversion" may be the result of the destruction of property in whole or in part, the theft of property, the seizure of property, the requisition or condemnation of property, or the threat or imminence of requisition or condemnation of property. An "involuntary conversion" may be a conversion into similar property or into money or into dissimilar property. M.S.A. 290.13, Subd. 4 provides that, under certain specified circumstances, any gain which is realized from an involuntary conversion shall not be recognized. In cases where property is converted into other property similar or related in service or use to the converted property, no gain shall be recognized regardless of when the disposition of the converted property occurred and regardless of whether or not the taxpayer elects to have the gain not recognized. In other types of involuntary conversion cases, however, the proceeds arising from the disposition of the converted property must (within the time limits specified) be reinvested in similar property in order to avoid recognition of any gain realized. Different rules for reinvestment apply, depending upon whether the disposition of the converted property occurred after 1954 or before 1955 (see Regs. 2013 (5)-2, 2013 (5)-3, 2013 (5)-4). M.S.A. 290.13, Subd. 4 applies only with respect to gains; losses from involuntary conversions are recognized or not recognized without regard to this regulation.

2013 (5)-2 INVOLUNTARY CONVERSION WHERE DISPOSITION OF CONVERTED PROPERTY OCCURRED AFTER DECEMBER 31, 1954.

(a) **In general.** This regulation applies only with respect to involuntary conversions where the disposition of the converted property occurred after December 31, 1954. The term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

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(b) **Conversion into similar property.** If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsory or involuntarily converted only into property similar or related in service or use to the property so converted, no gain shall be recognized. Such nonrecognition of gain is mandatory.

(c) **Conversion into money or into dissimilar property.** (1) If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or treat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, if the taxpayer purchased such other property, or such stock, for the purpose of replacing the property so converted and during the period specified in subparagraph (3) of this paragraph. For the purpose of M.S.A. 290.13, Subd. 4, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(2) All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement) shall be reported in the return for the taxable year or years in which any of such gain is realized. An election to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph shall be made by including such gain in gross income for such year or years only to such extent. If, at the time of filing such a return, the period within which the converted property must be replaced has expired, or if such an election is not desired, the gain should be included in gross income for such year or years in the regular manner. A failure to so include such gain in gross income in the regular manner shall be deemed to be an election by the taxpayer to have such gain recognized only to the extent provided in subparagraph (1) of this paragraph even though the details in connection with the conversion are not reported in such return. If, after having made an election under M.S.A. 290.13, Subd. 5 (3), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such

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recomputation should be in the form of an "amended return". If a decision is made to make an election under M.S.A. 290.13, Subd. 5 (3), after filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed. If the replacement of the converted property occurs in a year or years in which none of the gain on the conversion is realized, all of the details in connection with such replacement shall be reported in the return for such year or years.

(3) The period referred to in subparagraphs (1) and (2) of this paragraph is the period of time commencing with the date of the disposition of the converted property, or the date of the beginning of the treat or imminence of requisition or condemnation of the converted property, whichever is earlier, and ending one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or at the close of such later date as may be designated pursuant to an application of the taxpayer. Such application shall be made prior to the expiration of the one year after the close of the first taxable year in which any part of the gain from the conversion is realized, and shall contain all of the details in connection with the involuntary conversion. Such application shall be made to the Commissioner. No extension of time shall be granted pursuant to such application unless the taxpayer can show reasonable cause for not being able to replace the converted property within the required period of time.

(4) Property or stock purchased before the disposition of the converted property shall be considered to have been purchased for the purpose of replacing the converted property only if such property or stock is held by the taxpayer on the date of the disposition of the converted property. Property or stock shall be considered to have been purchased only if, but for the provisions of the last paragraph of M.S.A. 290.13, Subd. 5, the unadjusted basis of such property or stock would be its cost to the taxpayer within the meaning of M.S.A. 290.14. If the taxpayer's unadjusted basis of the replacement property would be determined, in the absence of the last paragraph of M.S.A. 290.13, Subd. 5, under any of the exceptions referred to in M.S.A. 290.14, the unadjusted basis of the property would not be its cost within the meaning of M.S.A. 290.14. For example, if property similar or related in service or use to the converted property is acquired by gift and its basis is determined under M.S.A. 290.14, such property will not qualify as a replacement for the converted property.

(5) If a taxpayer makes an election under M.S.A. 290.13, Subd. 5 (3), any deficiency, for any taxable year in which

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any part of the gain upon the conversion is realized, which it (is) attributable to such gain may be assessed at any time before the expiration of three years from the date the commissioner with whom the return for such year has been filed is notified by the taxpayer of the replacement of the converted property or of an intention not to replace, or of a failure to replace, within the required period, notwithstanding the provisions of M.S.A. 290.49, or the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain all of the details in connection with such replacement. Such notification should be made in the return for the taxable year or years in which the replacement occurs, or the intention not to replace is formed, or the period for replacement expires, if this return is filed with such commissioner. If this return is not filed with such commissioner, then such notification shall be made to such commissioner at the time of filing this return. If the taxpayer so desires, he may, in either event, also notify such commissioner before the filing of such return.

(6) If a taxpayer makes an election under M.S.A. 290.13, Subd. 5 (3), and the replacement property or stock was purchased before the beginning of the last taxable year in which any part of the gain upon the conversion is realized, any deficiency, for any taxable year ending before such last taxable year, which is attributable to such election may be assessed at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of M.S.A. 290.49 of the provisions of any law or rule of law which would otherwise prevent such assessment.

(7) If the taxpayer makes an election under M.S.A. 290.13, Subd. 5 (3), the gain upon the conversion shall be recognized to the extent that the amount realized upon such conversion exceeds the cost of the replacement property or stock, regardless of whether such amount is realized in one or more taxable years.

(8) The proceeds of a use and occupancy insurance contract, which by its term insured against actual loss sustained of net profits in the business, are not proceeds of an involuntary conversion but are income in the same manner that the profits for which they are substituted would have been.

(9) There is no investment in property similar in character and devoted to a similar use if—

(i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

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(ii) The proceeds of conversion of real property are applied in reduction of indebtedness previously incurred in the purchase of a leasehold.

(iii) The owner of a requisitioned tug uses the proceeds to buy barges.

(10) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation, the amount so retained shall be deducted from the gross award in determining the amount of the net award.

(11) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property, and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. If, in a condemnation proceeding, the Government makes an award to a mortgagee to satisfy a mortgage on the condemned property, the amount of such award shall be considered as a part of the amount realized upon the conversion regardless of whether or not the taxpayer was personally liable for the mortgage debt. Thus, if a taxpayer has acquired property worth $100,000 subject to a $50,000 mortgage (regardless of whether or not he was personally liable for the mortgage debt) and, in a condemnation proceeding, the Government awards the taxpayer $60,000 and awards the mortgagee $50,000 in satisfaction of the mortgage, the entire $110,000 is considered to be the "amount realized" by the taxpayer.

(12) An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

2013 (5)-6 BASIS OF PROPERTY ACQUIRED AS A RESULT OF INVOLUNTARY CONVERSION.

(a) The provisions of the first sentence of the last paragraph of M.S.A. 290.13, Subd. 5 may be illustrated by the following example:

Example: A's airplane which has an adjusted basis of $50,000 is destroyed in 1950 and A receives in 1951 insurance in the amount of $100,000. If A invests $75,000 in a new airplane, taxable gain to the extent of $25,000 would be recognized. The basis for the new airplane is $50,000; that is, the adjusted basis of the old airplane ($50,000) minus the money received by the taxpayer which was not expended in the acquisition of the new airplane

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($25,000) plus the amount of gain recognized upon the conversion ($25,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

(b) The provisions of the last sentence of the last paragraph of M.S.A. 290.13, Subd. 5 may be illustrated by the following example:

Example: A taxpayer realizes $22,000 from the involuntary conversion of his barn in 1956; the adjusted basis of the barn to him was $10,000 and he spent in the same year $20,000 for a new barn which resulted in nonrecognition of $10,000 of the $12,000 gain on the conversion. The basis of the new barn to the taxpayer would be $10,000—the cost of the new barn ($20,000) less the amount of the gain not recognized on the conversion ($10,000). If the replacement of the converted barn had been made by the purchase of two smaller barns which, together, were similar or related in service or use to the converted barn and which cost $8,000 and $12,000, respectively, then the basis of the two barns would be $4,000 and $6,000, respectively, the total basis of the purchased property ($10,000) allocated in proportion to their respective costs

$$\left(\frac{8{,}000}{20{,}000} \text{ of } \$10{,}000 \text{ or } \$4{,}000; \text{ and } \frac{12{,}000}{20{,}000} \text{ of } \$10{,}000, \text{ or } \$6{,}000\right).$$

2013 (10) CERTAIN EXCHANGES OF INSURANCE POLICIES.

Under the provisions of M.S.A. 290.13, Subd. 10 no gain or loss is recognized on the exchange of—

(a) A contract of life insurance for another contract of life insurance or for an endowment or annuity contract;

(b) A contract of endowment insurance for another contract of endowment insurance providing for regular payments beginning at a date not later than the date payments would have been under the contract exchanged, or an annuity contract; or

(c) An annuity contract for another annuity contract, but M.S.A. 290.13, Subd. 10 does not apply to such exchanges if the policies exchanged do not relate to the same insured. The exchange, without recognition of gain or loss, of an annuity contract for another annuity contract under M.S.A. 290.13, Subd. 10 is limited to cases where the same person or persons are the obligee or obligees under the contract received in exchange as under the original contract. This regulation and M.S.A. 290.13, Subd. 10 do not apply to transactions involving the exchange of an endowment contract or annuity contract for a life insurance

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contract, nor an annuity contract for an endowment contract. In the case of such exchanges, any gain or loss shall be recognized. In the case of exchanges which would be governed by M.S.A. 290.13, Subd. 10 except for the fact that the property received in exchange consists not only of property which could otherwise be received without the recognition of gain or loss, but also of other property or money, see M.S.A. 290.13, Subd. 2 and 4 and the regulations thereunder. Such an exchange does not come within the provisions of M.S.A. 290.13, Subd. 10. Determination of the basis of property acquired in an exchange under M.S.A. 290.13, Subd. 10 shall be governed by M.S.A. 290.14 (5) and the regulations thereunder.

2013.1 (1) RULES APPLICABLE WITH RESPECT TO DISTRIBUTIONS OF MONEY AND OTHER PROPERTY.

(a) **General.** M.S.A. 290.131, Subd. 1 provides the general rule for treatment of distributions in taxable years beginning after December 31, 1956, of property by a corporation to a shareholder with respect to its stock. The term "property" is defined in M.S.A. 290.133, Subd. 2 (a). Such distributions, except as otherwise provided in Chapter 290, shall be treated as provided in M.S.A. 290.131, Subd. 1 (c). Under M.S.A. 290.131, Subd. 1 (c), distributions may be included in gross income, applied against and reduce the adjusted basis of the stock, treated as gain from the sale or exchange of property, or (in the case of certain distributions out of increase in value accrued before January 1, 1933) may be exempt from tax. The amount of the distributions to which M.S.A. 290.131, Subd. 1 applies is determined in accordance with the provisions of M.S.A. 290.131, Subd. 1 (b). The basis of property received in a distribution to which M.S.A. 290.131, Subd. 1 applies is determined in accordance with the provisions of M.S.A. 290.131, Subd. 1 (d). Accordingly, except as otherwise provided in Chapter 290, a distribution in a taxable year beginning after December 31, 1956, of property by a corporation to a shareholder with respect to its stock shall be included in gross income to the extent the amount distributed is considered a dividend under M.S.A. 290.133, Subd. 1. For examples of distributions treated otherwise, see M.S.A. 290.01, Subd. 21, 290.131, Subd. 1 (c) (2), (c) (3) (B), (e), 290.131, Subd. 2 (b), 290.131, Subd. 3, and 290.131, Subd. 5. See also M.S.A. 290.134, 290.135 (relating to distributions in partial or complete liquidation), 290.136 (relating to corporate organizations and reorganizations), and 290.137 (relating to insolvency reorganizations).

(b) **Time of inclusion in gross income and of determination of fair market value.** A distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly

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made subject to their demands. However, if such distribution is a distribution other than in cash, the fair market value of the property shall be determined as of the date of distribution without regard to whether such date is the same as that on which the distribution is includible in gross income. For example, if a corporation distributes a taxable dividend in property (the adjusted basis of which exceeds its fair market value on December 31, 1957) on December 31, 1957, which is received by, or unqualifiedly made subject to the demand of, its shareholders on January 2, 1958, the amount to be included in the gross income of the shareholders will be the fair market value of such property on December 31, 1957, although such amount will not be includible in the gross income of the shareholders until January 2, 1958.

(c) **Application of subdivision to shareholders.** M.S.A. 290.131, Subd. 1 is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such.

(d) **Distributions of property to corporate shareholders.** If property (other than money and other than the obligations of the distributing corporation) is distributed in kind to a shareholder which is a corporation and the fair market value of such property is greater than the adjusted basis in the hands of the distributing corporation, only the adjusted basis of such property (determined immediately before the distribution and increased for any gain recognized to the distributing corporation under M.S.A. 290.132, Subd. 1 (b) and (c)) shall be taken into account under M.S.A. 290.131, Subd. 1 (c). Thus, in such a case, the amount of such a dividend in kind under M.S.A. 290.131, Subd. 1 (c) (1) may not exceed such adjusted basis. Similarly, in such cases where the distribution is not out of earnings and profits, the amount of the reduction in basis of the shareholder's stock and the amount of any gain resulting from such distribution are determined by reference to the adjusted basis of the property distributed. If the property distributed is money, the amount of the distribution shall be the amount of such money. If the property distributed consists of the obligations of the distributing corporation, or stock of the distributing corporation treated as property under M.S.A. 290.131, Subd. 5 (b), or rights to acquire such stock treated as propery under M.S.A. 290.131, Subd. 5 (b), the amount of such distribution shall be an amount equal to the fair market value of such obligations, stock, or rights.

(e) **Adjusted basis.** In determining the adjusted basis of property distributed in the hands of the distributing corporation immediately before the distribution for purposes of M.S.A. 290.131, Subd. 1 (b) (1) (B) (ii) and (d) (2) (B), the basis to be used shall be the basis for determining gain upon a sale or exchange.

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(f) *Examples.* The application of M.S.A. 290.131, Subd. 1 may be illustrated by the following examples:

Example (1). On January 1, 1957, A, an individual, owned all of the stock of Corporation M with an adjusted basis of $2,000. During 1957, A received distributions from Corporation M totaling $30,000, consisting of $10,000 in cash and listed securities having a basis in the hands of Corporation M and a fair market value on the date distributed of $20,000. Corporation M's taxable year is the calendar year. As of December 31, 1956, Corporation M had earnings and profits accumulated after December 31, 1932, in the amount of $26,000, and it had no earnings and profits and no deficit for 1957. Of the $30,000 received by A, $26,000 will be treated as an ordinary dividend; the remaining $4,000 will be applied against the adjusted basis of his stock; the $2,000 in excess of the adjusted basis of his stock will either be treated as gain from the sale or exchange of property (under M.S.A. 290.131, Subd. 1 (c) (3) (A)) or, if out of increase in value accrued before January 1, 1933, will (under M.S.A. 290.131, Subd. 1 (c) (3) (B)) be exempt from tax. If A subsequently sells his stock in Corporation M, the basis for determining gain or loss on the sale will be zero.

Example (2). The facts are the same as in *Example 1* with the exceptions that the sole shareholder of Corporation M is Corporation W and that the securities which were distributed had an adjusted basis to Corporation M of $15,000. The distribution received by Corporation W totals $25,000 consisting of $10,000 in cash and securities with an adjusted basis of $15,000. The total $25,000 will be treated as a dividend to Corporation W since the earnings and profits of Corporation M ($26,000) are in excess of the amount of the distribution.

Example (3). Corporation X owns timber land which it acquired prior to January 1, 1933, at a cost of $50,000 with $5,000 allocated as the separate cost of the land. On January 1, 1933, this property had a fair market value of $150,000 of which $135,000 was attributable to the timber and $15,000 to the land. All of the timber was cut prior to 1957 and the full appreciation in the value thereof, $90,000 ($135,000-$45,000), realized through depletion allowances based on January 1, 1933, value. None of this surplus from realized appreciation had been distributed. In 1957, Corporation X sold the land for $20,000 thereby realizing a gain of $15,000. Of this gain, $10,000 is due to realized appreciation in value which accrued before January 1, 1933 ($15,000-$5,000). Of the gain of $15,000, $5,000 is taxable. Therefore, at December 31, 1957, Corporation X had a surplus from realized appreciation in the amount of $100,000. It had no accumulated earnings and profits and no deficit at January 1, 1957. The net earnings for 1957 (including the $5,000 gain on the sale of the land) were $20,000. During 1957, Corporation X distributed

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$75,000 to its stockholders. Of this amount, $20,000 will be treated as a dividend. The remaining $55,000, which is a distribution of realized appreciation, will be applied against and reduce the adjusted basis of the shareholders' stock. If any part of the $55,000 is in excess of the adjusted basis of a shareholder's stock, such part will be exempt from tax.

(g) **Reduction for liabilities.** For the purpose of M.S.A. 290.131, Subd. 1 (a), the amount of any distribution shall be reduced by—

(1) The amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(2) The amount of any liability to which the property received by the shareholder is subject immediately before and immediately after the distribution.

Such reduction, however, shall not cause the amount of the distribution to be reduced below zero.

(h) **Basis.** The basis of property received in the distribution to which M.S.A. 290.131, Subd. 1 applies shall be—

(1) If the shareholder is not a corporation, the fair market value of such property;

(2) If the shareholder is a corporation—

(i) In the case of a distribution of the obligations of the distributing corporation or of the stock of such corporation or rights to acquire such stock (if such stock or rights are treated as property under M.S.A. 290.131, Subd. 5 (b)), the fair market value of such obligations, stock, or rights;

(ii) In the case of the distribution of any other property, whichever of the following is the lesser—

(a) The fair market value of such property; or

(b) The adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property increased in the amount of gain to the distributing corporation which is recognized under M.S.A. 290.132, Subd. 1 (b) (relating to distributions of LIFO inventory) or under M.S.A. 290.132, Subd. 1 (c) (relating to distributions of property subject to liabilities in excess of basis).

(j) **Transfers for less than fair market value.** If property is transferred by a corporation to a shareholder which is not a corporation for an amount less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which M.S.A. 290.131, Subd. 1 applies. In such case, the amount of the distribution shall be the differ-

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ence between the amount paid for the property and its fair market value. If property is transferred in a sale or exchange by a corporation to a shareholder which is a corporation, for an amount less than its fair market value and also less than its adjusted basis, such shareholder shall be treated as having received a distribution to which M.S.A. 290.131, Subd. 1 applies, and—

(1) Where the fair market value of the property equals or exceeds its adjusted basis in the hands of the distributing corporation the amount of the distribution shall be the excess of the adjusted basis over the amount paid for the property;

(2) Where the fair market value of the property is less than its adjusted basis in the hands of the distributing corporation, the amount of the distribution shall be the excess of such fair market value over the amount paid for the property. In all cases, the earnings and profits of the distributing corporation shall be decreased by the excess of the basis of the property in the hands of the distributing corporation over the amount received therefor. In computing gain or loss from the subsequent sale of such property, its basis shall be the amount paid for the property increased by the amount of the distribution.

(k) **Application of rule respecting transfers for less than fair market value.** The application of paragraph (j) of this regulation may be illustrated by the following example:

Example. On January 1, 1957, A, an individual shareholder of Corporation X, purchased property from that corporation for $20. The fair market value of such property was $100, and its basis in the hands of Corporation X was $25. The amount of the distribution determined under M.S.A. 290.131, Subd. 1 (b) is $80. If A were a corporation, the amount of the distribution would be $5, the excess of the basis of the property in the hands of Corporation X over the amount received therefor. The basis of such property to Corporation A would be $25. If the basis of the property in the hands of Corporation X were $10, the corporate shareholder, A, would not receive a distribution. The basis of such property to Corporation A would be $20. Whether or not A is a corporation, the excess of the amount paid over the basis of the property in the handle of Corporation X ($20 over $10) would be a taxable gain to Corporation X.

(1) **Transactions treated as distributions.** A distribution to shareholders with respect to their stock is within the terms of M.S.A. 290.131, Subd. 1 although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a formal sense. This is most likely to occur in the case of a recapitalization, a reincorporation, or a merger of a corporation with a newly organized corporation having substantially no

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property. For example, if a corporation having only common stock outstanding, exchanges one share of newly issued common stock and one bond in the principal amount of $10 for each share of outstanding common stock, the distribution of the bonds will be a distribution of property (to the extent of their fair market value) to which M.S.A. 290.131, Subd. 1 applies, even though the exchange of common stock for common stock may be pursuant to a plan of reorganization under the terms of M.S.A. 290.136, Subd. 9 (a) (1) (E) (recapitalization) and even though the exchange of common stock for common stock may be tax free by virtue of M.S.A. 290.136, Subd. 2.

(m) **Cancellation of indebtedness.** The cancellation of indebtedness of a shareholder by a corporation shall be treated as a distribution of property.

(n) **Cross references.** For certain rules relating to adjustments to earnings and profits and for determining the extent to which a distribution is a dividend, see M.S.A. 290.132, Subd. 2, and M.S.A. 290.133, Subd. 1 and regulations thereunder.

2013.2 (2)-6 EARNINGS AND PROFITS.

(a) In determining the amount of earnings and profits (whether of the taxable year, or accumulated since December 31, 1932, or accumulated before January 1, 1933) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the amount of the earnings and profits in any case will be dependent upon the method of accounting properly employed in computing taxable net income. For instance, a corporation keeping its books and filing its income tax returns on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in M.S.A. 290.07, Subd. 5 shall, with respect to the installment transactions, compute earnings and profits on such basis.

(b) Among the items entering into the computation of corporate earnings and profits for a particular period are all income exempted by statute, income not taxable by the State of Minnesota under the Constitution of the State of Minnesota, as well as

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all items includible in gross income under M.S.A. 290.01, Subd. 20. Gains and losses within the purview of M.S.A. 290.12 through 290.16 are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under those sections. Interest on bonds of the State of Minnesota and of the United States and certain other obligations, although not taxable when received by a corporation taxable under M.S.A. 290.03, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

(c) (1) In the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to January 1, 1933 value. In computing the earnings and profits for any period beginning after December 31, 1932, the only depletion or depreciation deductions to be considered are those based on (i) cost or other basis, if the depletable or depreciable asset was acquired subsequent to December 31, 1932, or (ii) adjusted cost or January 1, 1933, value, whichever is higher if acquired before January 1, 1933. Where the basis of property in the hands of a corporation is a substituted basis, such basis and not the fair market value of the property at the time of the acquisition by the corporation is the basis for computing depletion and depreciation for the purpose of determining earnings and profits of the corporation.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. Oil producing property which A had acquired in 1949 at a cost of $28,000 was transferred to Corporation Y in December 1951, in exchange for all of its capital stock. The fair market value of the stock and of the property was of the date of the transfer was $247,000. Corporation Y, after four years' operation, effected in 1955 a cash distribution to A in the amount of $165,000. In determining the extent to which the earnings and profits of Corporation Y available for dividend distributions have been increased as the result of production and sale of oil, the depletion to be taken into account is to be computed upon the basis of $28,000 established in the nontaxable exchange in 1951 regardless of the fair market value of the property or of the stock issued in exchange therefor.

(d) A loss sustained for a year before the taxable year does not affect the earnings and profits of the taxable year. However, in determining the earnings and profits accumulated since December 31, 1932, the excess of a loss sustained for a year subsequent to December 31, 1932, over the undistributed earnings and profits accumulated since December 31, 1932, and before the year for which the loss was sustained, reduces surplus as of January 1, 1933 to the extent of such excess. If the surplus as of January

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1, 1933 was sufficient to absorb such excess, distributions to shareholders after the year of the loss are out of earnings and profits accumulated since the year of the loss to the extent of such earnings.

2013.2 (2)-7 EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS REALIZED AFTER DECEMBER 31, 1932.

(a) In order to determine the effect on earnings and profits of gain or loss realized from the sale or other disposition (after December 31, 1932) of property by a corporation, M.S.A. 290.132, Subd. 2 (f) (1) prescribes certain rules for—

(1) The computation of the total earnings and profits of the corporation of most frequent application in determining invested capital; and

(2) The computation of earnings and profits of the corporation for any period beginning after December 31, 1932, of most frequent application in determining the source of dividend distributions.

Such rules are applicable whenever under any provision of Chapter 290 it is necessary to compute either the total earnings and profits of the corporation or the earnings and profits for any period beginning after December 31, 1932. For example, since the earnings and profits accumulated after December 31, 1932, or the earnings and profits of the taxable year, are earnings and profits for a period beginning after December 31, 1932, the determination of either must be in accordance with the rules herein prescribed for the ascertainment of earnings and profits for any period beginning after December 31, 1932. Under subparagraph (1) of this paragraph, such gain or loss is determined by using the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, but disregarding value as of January 1, 1933. Under subparagraph (2) of this paragraph, there is used such adjusted basis for determining gain, giving effect to the value as of January 1, 1933, whenever applicable. In both cases the rules are the same as those governing depreciation and depletion in computing earnings and profits (see Reg. 2013.2 (2)-6). Under both subparagraphs (1) and (2) of this paragraph, the adjusted basis is subject to the limitations of the third sentence of M.S.A. 290.132, Subd. 2 (f) (1) requiring the use of adjustments proper in determining earnings and profits. The proper adjustments may differ under (A) and (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) depending upon the basis to which the adjustments are to be made. If the application of (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) results in a loss and if the application of (A) of such sentence to the same transaction

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reaches a different result, then the loss under (B) of such first sentence will be subject to the adjustment thereto required by M.S.A. 290.132, Subd. 2 (g) (2). (See Reg. 2013.2 (2)-9.)

(b) (1) The gain or loss so realized increases or decreases the earnings and profits to, but not beyond, the extent to which such gain or loss was recognized in computing taxable income under the law applicable to the year in which such sale or disposition was made. As used in this paragraph, the term "recognized" has reference to that kind of realized gain or loss which is recognized for income tax purposes by the statute applicable to the year in which the gain or loss was realized. For example, see M.S.A. 290.136, Subd. 4. A loss (other than a wash sale loss with respect to which a deduction is disallowed) may be recognized though not allowed as a deduction (by reason, for example, of the operation of M.S.A. 290.10 (6) and 290.16, Subd. 4) but the mere fact that it is not allowed does not prevent decrease in earnings and profits by the amount of such disallowed loss. Wash sale losses, are deemed nonrecognized losses and do not reduce earnings or profits. The "recognized" gain or loss for the purpose of computing earnings and profits is determined by applying the recognition provisions to the realized gain or loss computed under the provisions of M.S.A. 290.132, Subd. 2 (f) (1) as distinguished from the realized gain or loss used in computing taxable income.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). Corporation X on January 1, 1952, owned stock in Corporation Y which it had acquired from Corporation Y in December 1951, in an exchange transaction in which no gain or loss was recognized. The adjusted basis to Corporation X of the property exchanged by it for the stock in Corporation Y was $30,000. The fair market value of the stock in Corporation Y when received by Corporation X was $930,000. On April 9, 1957, Corporation X made a cash distribution of $900,000 and, except for the possible effect of the transaction in 1951, had no earnings or profits accumulated after December 31, 1932, and had no earnings or profits for the taxable year. The amount of $900,000 representing the excess of the fair market value of the stock of Corporation Y over the adjusted basis of the property exchanged therefor was not recognized gain to Corporation X under the provisions of M.S.A. 290.13. Accordingly, the earnings and profits of Corporation X are not increased by $900,000, the amount of the gain realized but not a recognized in the exchange, and the distribution was not taxable dividend. The basis in the hands of Corporation Y of the property acquired by it from Corporation X is $30,000. If such property is thereafter sold by Corporation Y, gain or loss will be computed on such basis of $30,000, and earnings and profits will be increased or decreased accordingly.

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Example (2). On January 2, 1910, Corporation M acquired nondepreciable property at a cost of $1,000. On January 1, 1933, the fair market value of such property in the hands of Corporation M was $2,200. On December 31, 1952, Corporation M transfers such property to Corporation N in exchange for $1,900 in cash and all Corporation N's stock, which has a fair market value of $1,100. For the purpose of computing the total earnings and profits of Corporation M, the gain on such transaction is $2,000 (the sum of $1,900 in cash and stock worth $1,100 minus $1,000, the adjusted basis for computing gain determined without regard to January 1, 1933, value), $1,900 of which is recognized under M.S.A. 290.136, Subd. 4, since this was the amount of money received, although for the purpose of computing net income the gain is only $800 (the sum of $1,900 in cash and stock worth $1,100, minus $2,200, the adjusted basis for computing gain determined by giving effect to January 1, 1933, value). Such earnings and profits will therefore be increased by $1,900. In computing the earnings and profits of Corporation M for any period beginning after December 31, 1932, however, the gain arising from the transaction, like the taxable gain, is only $800, all of which is recognized under M.S.A. 290.13, Subd. 2, the money received being in excess of such amount. Such earnings and profits will therefore be increased by only $800 as a result of the transaction. For increase in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after January 1, 1933, see Reg. 2013.2 (2)-9.

(c) The third sentence of M.S.A. 290.132, Subd. 2 (f) (1) provides for cases in which the adjustments, prescribed in M.S.A. 290.12, Subd. 2, to the basis indicated in (A) or (B), as the case may be, of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1), differ from the adjustments to such basis proper for the purpose of determining earnings or profits. The adjustments provided by such third sentence reflect the treatment provided by Reg. 2013.2 (2)-6 relative to cases where the deductions for depletion and depreciation in computing taxable net income differ from the deductions proper for the purpose of computing earnings and profits.

(d) For adjustment and allocation of the earnings and profits of the transferor as between the transferor and the transferee in cases where the transfer of property by one corporation to and other corporation results in the nonrecognition in whole or in part of gain or loss, see Reg. 2013.2 (2)-10; and see M.S.A. 290.138, Subd. 1 for earnings and profits of successor corporations in certain transactions.

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2013.2 (2)-8 EFFECT ON EARNINGS AND PROFITS OF RECEIPT OF TAX-FREE DISTRIBUTIONS REQUIRING ADJUSTMENT OR ALLOCATION OF BASIS OF STOCK.

(a) In order to determine the effect on earnings and profits, where a corporation receives (after December 31, 1932) from a second corporation a distribution which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, M.S.A. 290.132, Subd. 2 (f) prescribes certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the first or receiving corporation in the following cases: (1) No such increase shall be made in respect of the part of such distribution which (under the law applicable to the year in which the distribution was made) is directly applied in reduction of the basis of the stock in respect of which the distribution was made and (2) no such increase shall be made if (under the law applicable to the year in which the distribution was made) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would but for M.S.A. 290.131, Subd. 7 (b) be so allocated). Where, therefore, the law (applicable to the year in which the distribution was made, as, for example, a distribution in 1945 from earnings and profits accumulated before January 1, 1933) requires that the amount of such distribution shall be applied against and reduce the basis of the stock with respect to which the distribution was made, there is no increase in the earnings and profits by reason of the receipt of such distribution. Similarly, where there is received by a corporation a distribution from another corporation in the form of a stock dividend and the law applicable to the year in which such distribution was made requires the allocation, as between the old stock and the stock received as a dividend, of the basis of the old stock (or such basis would but for M.S.A. 290.131, Subd. 7 (b) be so allocated), then there is no increase in the earnings and profits by reason of the receipt of such stock dividend even though such stock dividend constitutes income within the meaning of the sixteenth amendment to the Constitution of the United States.

(b) The principles set forth in paragraph (a) of this regulation may be illustrated by the following examples:

Example (1). Corporation X in 1957 distributed to Corporation Y, one of its shareholders, $10,000 which was out of earnings or profits accomulated before January 1, 1933, and did not exceed the adjusted basis of the stock in respect of which the distribution was made. This amount of $10,000 was, therefore, a tax-free distribution and under the provisions of M.S.A. 290.131, Subd. 1 (c) (2) must be applied against and reduce the adjusted

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basis of the stock in respect of which the distribution was made. The earnings and profits of Corporation Y are not increased by reason of the receipt of this distribution.

Example (2). Corporation Z in 1957 had outstanding common and preferred stock of which Corporation Y held 100 shares of the common and no preferred. The stock had a cost basis to Corporation Y of $100 per share, or a total cost of $10,000. In December of that year it received a dividend of 100 shares of the preferred stock of Corporation Z. Such distribution is a stock dividend which, under M.S.A. 290.131, Subd. 5, was not taxable and was accordingly not included in the gross income of Corporation Y. The original cost of $10,000 is allocated to the 200 shares of Corporation Z none of which has been sold or otherwise disposed of by Corporation Y. See M.S.A. 290.131, Subd. 7 and Reg. 2013.1 (7). The earnings and profits of Corporation Y are not increased by reason of the receipt of such stock dividend.

2013.2 (2)-9 ADJUSTMENTS TO EARNINGS AND PROFITS REFLECTING INCREASE IN VALUE ACCRUED BEFORE JANUARY 1, 1933.

(a) In order to determine, for the purpose of ascertaining the source of dividend distributions, that part of the earnings and profits which is represented by increase in value of property accrued before, but realized on or after, January 1, 1933, M.S.A. 290.132, Subd. 2 (g) prescribes certain rules.

(b) (1) M.S.A. 290.132, Subd. 2 (g) (1) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after January 1, 1933.

(2) The effect of M.S.A. 290.132, Subd. 2 (g) (1) may be illustrated by the following examples:

Example (1). Corporation X acquired nondepreciable property before January 1, 1933, at a cost of $10,000. Its fair market value as of January 1, 1933, was $12,000 and it was sold in 1957 for $15,000. The increase in earnings and profits based on the value as of January 1, 1933, representing earnings and profits accumulated since December 31, 1932, is $3,000. If the basis is determined without regard to the value as of January 1, 1933, there would be an increase in earnings and profits of $5,000. The difference of $2,000 ($5,000 minus $3,000) represents the increase to be made in that part of the earnings and profits of Corporation X consisting of the increase in value of property accrued before, but realized on or after, January 1, 1933.

Example (2). Corporation Y acquired depreciable property in 1928 at a cost of $100,000. Assuming no additions or bet-

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terments, and that the depreciation sustained before January 1, 1933, was $10,000, the adjusted cost as of that date was $90,000. Its fair market value as of January 1, 1933, was $94,000 and on December 31, 1957, it was sold for $55,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $94,000 as of January 1, 1933, adjusted for depreciation for the period subsequent to December 31, 1932, computed on such fair market value. If the amount of the depreciation deduction allowed after December 31, 1932, and properly allowable for each of such years to the date of the sale in 1957 is the aggregate sum of $52,222.25, the adjusted basis for determining gain in 1957 ($94,000 less $52,222.25) is $41,777.75 and the gain would be $13,222.25 ($55,000 less $41,777.75). The increase in earnings and profits accumulated since December 31, 1932, by reason of the sale, based on the value as of January 1, 1933, adjusted for depreciation, is $13,222.25. If the depreciation since December 31, 1932, had been based on the adjusted cost of $90,000 ($100,000 less $10,000) instead of the January 1, 1933, value of $94,000, the depreciation sustained from that date to the date of sale would have been $50,000 instead of $52,222.25 and the actual gain on the sale based on the cost of $100,000 adjusted by depreciation on such cost to $40,000 ($100,000 reduced by the sum of $10,000 and $50,000) would be $15,000 ($55,00 less $40,000). If the adjusted basis of the property was determined without regard to the value as of January 1, 1933, there would be an increase in earnings and profits of $15,000. The difference of $1,777.75 ($15,000 minus $13,222.25) represents the increase to be made in that part of the earnings and profits of Corporation Y consisting of the increase in value of property accrued before, but realized on or after, January 1, 1933 (assuming that the proper increase in such surplus had been made each year for the difference between depreciation based on cost and the depreciation based on January 1, 1933, value). Thus, the total increase in that part of earnings and profits consisting of the increase in value of property accrued before, but realized on or after, January 1, 1933, is $4,000 ($94,000 less $90,000).

(c) (1) M.S.A. 290.132, Subd. 2 (g) (2) is an exception to the general rule in M.S.A. 290.132, Subd. 2 (g) (1) and also operates as a limitation on the application of M.S.A. 290.132, Subd. 2 (f). It provides that, if the application of part (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) to a sale or other disposition after December 31, 1932, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after December 31, 1932, then, notwithstanding M.S.A. 290.132, Subd. 2 (f) and in lieu of the rule provided in M.S.A. 290.132, Subd. 2 (g) (1), the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the

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adjusted basis computed without regard to the fair market value of the property on January 1, 1933. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after January 1, 1933.

(2) The application of M.S.A. 290.132, Subd. 2 (g) (2) may be illustrated by the following rules:

Example (1). Corporation Y acquired nondepreciable property before January 1, 1933, at a cost of $8,000. Its fair market value as of January 1, 1933, was $13,000, and it was sold in 1957 for $10,000. Under (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) the adjusted basis would be $13,000 and there would be a loss of $3,000. The application of (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) would result in a loss from the sale in 1957 to be applied in decrease of earnings and profits for that year. M.S.A. 290.132, Subd. 2 (g) (2), however, applies and the loss of $3,000 is reduced by the amount by which the adjusted basis of $13,000 exceeds the cost of $8,000 (the adjusted basis computed without regard to the value on January 1, 1933), namely $5,000. The amount of the loss is, accordingly, reduced from $3,000 to zero and there is no decrease in earnings and profits of Corporation Y for the year 1957 as a result of the sale. The amount applied in reduction of the decrease, namely, $5,000, exceeds $3,000. Accordingly, as a result of the sale the excess of $2,000 increases that part of the earnings and profits of Corporation Y consisting of increase in value of property accrued before, but realized on or after January 1, 1933.

Example (2). Corporation Z acquired nondepreciable property before January 1, 1933, at a cost of $10,000. Its fair market value as of January 1, 1933, was $12,000, and it was sold in 1957 for $8,000. Under (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) the adjusted basis would be $12,000 and there would be a loss of $4,000. The application of (B) of the first sentence of M.S.A. 290.132, Subd. 2 (f) (1) would result in a loss from the sale in 1957 to be applied in decrease of earnings and profits for that year. M.S.A. 290.132, Subd. 2 (g) (2), however, applies and the loss of $4,000 is reduced by the amount by which the adjusted basis of $12,000 exceeds the cost of $10,000 (the adjusted basis computed without regard to the value on January 1, 1933), namely $2,000. The amount of the loss is, accordingly, reduced from $4,000 to $2,000 and the decrease in earnings and profits of Corporation Z for the year 1957 as a result of the sale is $2,000 instead of $4,000. The amount applied in reduction of the decrease, namely, $2,000, does not exceed $4,000. Accordingly, as a result of the sale there is no increase

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in that part of the earnings and profits of Corporation Z consisting of increase in value of property accrued before, but realized on or after, January 1, 1933.

2013.3 (1)-1 DIVIDENDS.

(a) (1) The term "dividend" for the purpose of Chapter 290 comprises any distribution of property as defined in M.S.A. 290.133, Subd. 2 in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either—

(i) Earnings and profits accumulated since December 31, 1932, or

(ii) Earnings and profits of the taxable year computed without regard to the amount of the earnings and profits (whether of such year or accumulated since December 31, 1932) at the time the distribution was made.

The earnings and profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since December 31, 1932, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

(2) Where a corporation distributes property to its shareholders in a taxable year beginning after December 31,

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1956, the amount of the distribution which is a dividend to them may not exceed the earnings and profits of the distributing corporation.

(3) The rule of (2) above may be illustrated by the following example:

Example. X and Y, individuals, each own one-half of the stock of Corporation A which has earnings and profits of $10,000. Corporation A distributes property having a basis of $6,000 and a fair market value of $16,000 to its shareholders, each shareholder receiving property with a basis of $3,000 and with a fair market value of $8,000 in a distribution to which M.S.A. 290.131, Subd. 1 applies. The amount taxable to each shareholder as a dividend under M.S.A. 290.131, Subd. 1(c) is $5,000.

(b) The term "dividend" includes any distribution of property to shareholders to the extent made out of accumulated or current earnings and profits. See, however, M.S.A. 290.134, Subd. 1 (relating to distributions in complete or partial liquidation), M.S.A. 290.131, Subd. 1(e) (relating to distributions by personal service corporations), M.S.A. 290.131, Subd. 2(b) (relating to redemptions treated as amounts received from the sale or exchange of stock), and M.S.A. 290.131, Subd. 3 (relating to distributions in redemption of stock to pay death taxes). See also M.S.A. 290.131, Subd. 5(b) for certain distributions of stock or stock rights treated as distributions of property.

(d) The application of M.S.A. 290.133, Subd. 1 may be illustrated by the following example:

Example. At the beginning of the calendar year 1957, Corporation M had an operating deficit of $200,000 and the earnings and profits for the year amounted to $100,000. Beginning on March 16, 1957, the corporation made quarterly distributions of $25,000 during the taxable year to its shareholders. Each distribution is a taxable dividend in full, irrespective of the actual or the pro rata amount of the earnings and profits on hand at any of the dates of distribution, since the total distributions made during the year ($100,000) did not exceed the total earnings and profits of the year ($100,000).

2013.3 (1)-2 SOURCES OF DISTRIBUTION IN GENERAL.

(a) For the purpose of income taxation every distribution made by a corporation is made out of earnings and profits to the extent thereof and from the most recently accumulated earnings and profits. In determining the source of a distribution, consideration should be given first, to the earnings and profits of the taxable year; second, to the earnings and profits accumulated since December 31, 1932, only in the case where, and to the ex-

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tent that, the distributions made during the taxable year are not regarded as out of the earnings and profits of that year; third, to the earnings and profits accumulated before January 1, 1933, only after all the earnings and profits of the taxable year and all the earnings and profits accumulated since December 31, 1932, have been distributed; and, fourth, to sources other than earnings and profits only after the earnings and profits have been distributed.

(b) If the earnings and profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings and profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend. See Reg. 2013.3 (1)-2. If the distributions made during the taxable year consist only of money and exceed the earnings and profits of such year, then that proportion of each distribution which the total of the earnings and profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings and profits of that year. The portion of each such distribution which is not regarded as out of earnings and profits of the taxable year shall be considered a taxable dividend to the extent of the earnings and profits accumulated since December 31, 1932, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings and profits accumulated since December 31, 1932, and the actual earnings and profits to the date of a distribution within any taxable year cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made.

(c) The provisions of the regulation may be illustrated by the following example:

Example: At the beginning of the calendar year 1957, Corporation M had $12,000 in earnings and profits accumulated since December 31, 1932. Its earnings and profits for 1957 amounted to $30,000. During the year it made quarterly cash distributions of $15,000 each. Of each of the four distributions made $7,500 (that portion of $15,000 which the amount of $30,000, the total earnings and profits of the taxable year, bears to $60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, $7,500 and $4,500, respectively, were paid out of the earnings and profits accumulated after December 31, 1932, and before the taxable year, as follows:

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Distributions during 1957				
Date	Amount	Portion out of earnings and profits of the taxable year	Portion out of earnings accumulated since Dec. 31, 1932, and before the taxable year	Taxable amount of each distribution
Mar. 10	$15,000	$7,500	$7,500	$15,000
June 10	15,000	7,500	4,500	12,000
Sept. 10	15,000	7,500		7,500
Dec. 10	15,000	7,500		7,500
Total amount taxable as dividends.....				$42,000

(d) Any distribution by a corporation out of earnings and profits accumulated before January 1, 1933, or out of increase in value of property accrued before January 1, 1933 (whether or not realized by sale or other disposition, and, if realized, whether before, on, or after January 1, 1933), is not a dividend within the meaning of Chapter 290.

(e) A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings and profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property as provided in subsection (c) (3) (A) of M.S.A. 290.131, Subd. 1. A distribution made from that portion of a depletion reserve based upon a valuation as of January 1, 1933, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings and profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. See M.S.A. 290.131, Subd. 1. No distribution, however, can be made from such a reserve until all the earnings and profits of the corporation have first been distributed.

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2013.6 (8)-2 CERTAIN CONTRIBUTIONS TO CAPITAL.

The following rules shall be used in the application of M.S.A. 290.136, Subd. 8 (c):

(a) Property deemed to be acquired with contributed money shall be that property, if any, the acquisition of which was the purpose motivating the contribution;

(b) In the case of an excess of the amount of money contributed over the cost of the property deemed to be acquired with such money (as defined in paragraph (a) of this section) such excess shall be applied to the reduction of the basis (but not below zero) of other properties held by the corporation, on the last day of the 12-month period beginning on the day the contribution is received, in the following order—

(1) All property of a character subject to an allowance for depreciation (not including any properties as to which a deduction for amortization is allowable),

(2) Property with respect to which a deduction for amortization is allowable,

(3) Property with respect to which a deduction for depletion is allowable.

(4) All other remaining properties.

The reduction of the basis of each of the properties within each of the above categories shall be made in proportion to the relative basis of such properties.

(c) With the consent of the Commissioner, the taxpayer may, however, have the basis of the various units of property within a particular category adjusted in a manner different from the general rule set forth in paragraph (b) of this section. Variations from such rule may, for example, involve adjusting the basis of only certain units of the taxpayer's property within a given category. A request for variations from the general rule should be filed by the taxpayer with its return for the taxable year for which the transfer of the property has occurred.

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2014 BASIS FOR DETERMINING GAIN OR LOSS—GENERAL RULE.

The gain or loss basis of property acquired on or after January 1, 1933, is usually the cost of such property. However, this general rule is subject to certain exceptions which are set forth in M.S.A. 290.14 and Regs. 2014 (1) through 2014 (12). The term "basis" as used in M.S.A. 290.14 and in this regulation, means the basis before applying the adjustments required by M.S.A. 290.12.

2014 (1) PROPERTY INCLUDED IN INVENTORY.

If the property should have been included in the last inventory, the basis shall be the last inventory value thereof. The methods of computing inventory values are set forth in Reg. 2011 (2).

2014 (2) PROPERTY ACQUIRED BY GIFT ON OR AFTER JANUARY 1, 1933.

If the property was acquired by gift, the basis is the same as it would be if the property were being sold or otherwise disposed of by the last preceding owner who did not acquire it by gift. The substituted basis has the same result as though the property had never been made the subject of a gift. If the substituted basis cannot be determined, the basis then would be the fair market value of the property as of the date or approximate date of acquisition by such last preceding owner not acquiring it by gift and shall be ascertained by the Commissioner according to the best information the Commissioner is able to obtain. Persons making gifts of property should preserve an accessible record of the facts necessary to determine the cost of such property, in order to avoid an inaccurate appraisal at some future date.

2014 (3) PROPERTY ACQUIRED BY TRANSFER IN TRUST ON OR AFTER JANUARY 1, 1933.

In the case of property acquired by gift on or after January 1, 1933, through an inter vivos transfer in trust, the basis shall be the same as it would be if such property were being sold or

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otherwise disposed of by the grantor; and, for the purpose of applying the adjustments required by M.S.A. 290.12, the taxpayer who disposes of property acquired by gift through an inter vivos transfer in trust shall be treated as the owner from the time it was acquired by the grantor.

2014 (4)-1 BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) General Rule. The purpose of M.S.A. 290.14 (4) is, in general, to provide a basis for property acquired from a decedent which is equal to the value placed upon such property for purposes of the Minnesota inheritance tax. Accordingly, the general rule is that the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death. Property acquired from a decedent includes, principally, property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1956, property required to be included in determining the value of the decedent's gross estate under any provision of the Minnesota inheritance tax act. The general rule governing basis of property acquired from a decedent, as well as other rules prescribed elsewhere in this section, shall have no application if the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent.

(b) Scope And Application. With certain limitations, the general rule described in paragraph (a) of this section is applicable to the classes of property described in paragraphs (a) and (b) of 2014 (4)-2.

(c) Property To Which M.S.A. 290.14 (4) Does Not Apply. M.S.A. 290.14 (4) shall have no application to the following classes of property:

(1) Property which constitutes a right to receive an item of income in respect of a decedent under M.S.A. 290.077; and

(2) Restricted stock options described in M.S.A. 290.078 which the employee has not exercised at death, regardless of the date on which the employee died.

2014 (4)-2 PROPERTY ACQUIRED FROM A DECEDENT.

(a) In General. The following property, except where otherwise indicated, is considered to have been acquired from a decedent and the basis thereof is determined in accordance with the general rule in 2014 (4)-1.

(1) Without regard to the date of the decedent's death, property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, whether the property was acquired under the decedent's will or under the law governing the descent and distribution of the property of decedents.

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(2) Without regard to the date of the decedent's death, property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust.

(3) In the case of decedents property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved to the decedent at all times before his death to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

(4) Without regard to the date of the decedent's death, property passing without full and adequate consideration under a general power of appointment exercised by the decedent by will.

(b) Property Acquired From A Decedent Dying After December 31, 1956—(1) In General. In addition to the property described in paragraph (a) of this section, and except as otherwise provided in subparagraph (3) of this paragraph, in the case of a decedent dying after December 31, 1956, property shall also be considered to have been acquired from the decedent to the extent that both of the following conditions are met: (i) the property was acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), and (ii) the property is includible in the decedent's gross estate for Minnesota inheritance tax purposes because of such acquisition. The basis of such property in the hands of the person who acquired it from the decedent shall be determined in accordance with the general rule in 2014 (4)-1. See, however, 2014 (4)-6 for special adjustments if such property is acquired before the death of the decedent. See also subparagraph (3) for a description of property not within the scope of this paragraph.

(2) Rules For The Application Of Subparagraph (1). Except as provided in subparagraph (3), this paragraph generally includes all property acquired from a decedent, which is includible in the gross estate for Minnesota inheritance tax purposes of the decedent if the decedent died after December 31, 1956. It is not necessary for the application of this paragraph that an inheritance tax return be required to be filed for the estate of the decedent or that an inheritance tax be payable. Property acquired prior to the death of a decedent which is includible in the decedent's gross estate, for Minnesota inheritance tax purposes such as property transferred by a decedent in contemplation of death, and property held by a taxpayer and the decedent as joint tenants or as tenants by the entireties is within the scope of this paragraph. Also, this paragraph includes property acquired through the exercise or non-exercise of a power of appointment where such property is includible in the decedent's gross estate for Min-

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nesota inheritance tax purposes. It does not include property not so included for Minnesota inheritance tax purposes such as property not situated in the State.

(3) Exceptions To Application Of Paragraph (b). The rules in paragraph (b) are not applicable to the following property:

(i) Annuities described in M.S.A. 290.08, Subd. 4.

2014 (4)-3 OTHER BASIS RULES.

(a) Fair Market Value. For purposes of this section and 2014 (4)-1 the value of property as of the date of the decedent's death as appraised for the purpose of the Minnesota inheritance tax shall be deemed to be its fair market value.

(b) Property Acquired From A Decedent Dying Before January 1, 1933. If the decedent died before January 1, 1933, the fair market value on that date is taken in lieu of the fair market value on the date of death, but only to the same extent and for the same purposes as the fair market value on January 1, 1933, is taken under M.S.A. 290.15.

(c) Reinvestments By A Fiduciary. The basis of property acquired after the death of the decedent by a fiduciary as an investment is the cost or other basis of such property to the fiduciary, and not the fair market value of such property at the death of the decedent. For example, the executor of an estate purchases stock of X company at a price of $100 per share with the proceeds of the sale of property acquired from a decedent. At the date of the decedent's death the fair market value of such stock was $98 per share. The basis of such stock to the executor or to a legatee, assuming the stock is distributed, is $100 per share.

(d) Reinvestments Of Property Transferred During Life. Where property is transferred by a decedent during life and the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent, the general rule stated in 2014 (4)-1 (a) shall not apply to such property. However, in such a case, the basis of any property acquired by such donee in exchange for the original property, or of any property acquired by the donee through reinvesting the proceeds of the sale of the original property, shall be the fair market value of the property thus acquired at the date of the decedent's death if the property thus acquired is properly included in the decedent's gross estate for Minnesota inheritance tax purposes. These rules also apply to property acquired by the donee in any further exchanges or in further reinvestments. For example, on January 1, 1956, the decedent made a gift of real property to a trust for the benefit of his children, reserving to himself the power to revoke the trust at will. Prior to the decedent's death the trustee sold the real property and invested the proceeds in stock of the Y company at $50 per share.

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At the time of the decedent's death the value of such stock was $75 per share. The corpus of the trust was required to be included in the decedent's gross estate for Minnesota inheritance tax purposes owing to his reservation of the power of revocation. The basis of the Y company stock following the decedent's death is $75 per share. Moreover, if the trustee sold the Y Company stock before the decedent's death for $65 a share and reinvested the proceeds in Z company stock which increased in value to $85 per share at the time of the decedent's death, the basis of the Z company stock following the decedent's death would be $85 per share.

2014 (4)-4 UNIFORMITY OF BASIS; ADJUSTMENT TO BASIS

(a) In General. (1) The basis of property acquired from a decedent, as determined under M.S.A. 290.14 (4), is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or other instrument or under the laws of descent and distribution. The principle of uniform basis means that the basis of the property (to which proper adjustments must, of course, be made) will be the same, or uniform, whether the property is possessed or enjoyed by the executor or administrator, the heir, the legatee or devisee, or the trustee or beneficiary of a trust created by a will or an inter vivos trust. In determining the amount allowed or allowable to a taxpayer in computing taxable income as deductions for depreciation or depletion under M.S.A. 290.16, Subd. 1, the uniform basis of the property shall at all times be used and adjusted. The sale, exchange, or other disposition by a life tenant or remainderman of his interest in property will, for purposes of this section, have no effect upon the uniform basis of the property in the hands of those who acquired it from the decedent. Thus, gain or loss on sale of trust assets by the trustee will be determined without regard to the prior sale of any interest in the property. Moreover, any adjustment for depreciation shall be made to the uniform basis of the property without regard to such prior sale, exchange, or other disposition.

(2) Under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of the person taking the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise. Accordingly, there is a common acquisition date for all titles to property acquired from a decedent within the meaning of M.S.A. 290.14 (4), and, for this reason, a common or uniform basis for all such interests. For example, if distribution of personal property left by a decedent is not made until one year after his death, the basis of such property in the hands of the legatee is its fair market value at the time when the decedent died, and

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not when the legatee actually received the property. If the bequest is of the residue to trustees in trust, and the executors do not distribute the residue to such trustees until five years after the death of the decedent, the basis of each piece of property left by the decedent and thus received, in the hands of the trustees, is its fair market value at the time when the decedent dies. If the bequest is to trustees in trust to pay to A during his lifetime the income of the property bequeathed, and after his death to distribute such property to the survivors of a class, and upon A's death the property is distributed to the taxpayer as the sole survivor, the basis of such property, in the hands of the taxpayer, is its fair market value at the time when the decedent died. The purpose of Chapter 290 in prescribing a general uniform basis rule for property acquired from a decedent is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value resulting solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which is recognized as the measure of gain or loss.

(3) The principles stated in subparagraphs (1) and (2) of this paragraph do not apply to property transferred by an executor, administrator or trustee, to an heir, legatee, devisee or beneficiary under circumstances such that the transfer constitutes a sale or exchange. In such a case, gain or loss must be recognized by the transferor to the extent required by the income tax laws, and the transferee acquires a basis equal to the fair market value of the property on the date of the transfer. Thus, for example, if the trustee of a trust created by will transfers to a beneficiary, in satisfaction of a specific bequest of $10,000, securities which had a fair market value of $9,000 on the date of the decedent's death and $10,000 on the date of the transfer, the trust realizes a taxable gain of $1,000 and the basis of the securities in the hands of the beneficiary would be $10,000. As a further example, if the executor of an estate transfers to a trust property worth $200,000, which had a fair market value of $175,000 on the date of the decedent's death, in satisfaction of the decedent's bequest in trust for the benefit of his wife of cash or securities to be selected by the executor in an amount sufficient to utilize the marital deduction under the Internal Revenue Code to the maximum extent authorized by law (after taking into consideration any other property qualifying for the marital deduction), capital gain in the amount of $25,000 would be realized by the estate and

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the basis of the property in the hands of the trustees would be $200,000. If, on the other hand, the decedent bequeathed a fraction of his residuary estate to a trust for the benefit of his wife, which fraction will not change regardless of any fluctuations in value of property in the decedent's estate after his death, no gain or loss would be realized by the estate upon transfer of property to the trust, and the basis of the property in the hands of the trustees would be its fair market value on the date of the decedent's death.

(b) Multiple Interests. Where more than one person has an interest in property acquired from a decedent, the basis of such property shall be determined and adjusted without regard to the multiple interests. The basis for computing gain or loss on the sale of any one of such multiple interests shall be determined under 2014 (4)-5. Thus, the deductions for depreciation and for depletion allowed or allowable, under M.S.A. 290.09, Subd. 7 and Subd. 8, to a legal life tenant as if the life tenant were the absolute owner of the property, constitute an adjustment to the basis of the property not only in the hands of the life tenant, but also in the hands of the remainderman and every other person to whom the same uniform basis is applicable. Similarly, the deductions allowed or allowable under M.S.A. 290.09, Subd. 7 and Subd. 8, both to the trustee and to the trust beneficiaries, constitute an adjustment to the basis of the property not only in the hands of the trustee, but also in the hands of the trust beneficiaries and every other person to whom the uniform basis is applicable. Similarly, adjustments in respect of capital expenditures or losses, tax-free distributions, or other distributions applicable in reduction of basis, or other items for which the basis is adjustable are made without regard to which one of the persons to whom the same uniform basis is applicable makes the capital expenditures or sustains the capital losses, or to whom the tax-free or other distributions are made, or to whom the deductions are allowed or allowable. See 2014 (4)-6 for adjustments in respect of property acquired from a decedent prior to his death.

(c) Records. The executor or other legal representative of the decedent, the fiduciary of a trust under a will, the life tenant and every other person to whom a uniform basis under this section is applicable, shall maintain records showing in detail all deductions, distributions, or other items for which adjustment to basis is required to be made by M.S.A. 290.08, Subd. 20 and 290.12, Subd. 2, and shall furnish to the commissioner such information with respect to those adjustments as he may require.

2014 (4)-5 GAIN OR LOSS.

(a) Sale Or Other Disposition Of A Life Interest, Remainder Interest, Or Other Interest In Property Acquired From A Decedent. (1) The gain or loss from a sale or other disposition of a life

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interest, remainder interest, or other interest in property acquired from a decedent is determined by comparing the amount of the proceeds with the amount of that part of the adjusted uniform basis which is assignable to the interest sold or otherwise disposed of. The adjusted uniform basis is the uniform basis of the entire property adjusted to the time of sale or other disposition of any such interest as required by M.S.A. 290.08, Subd. 20 and 290.12, Subd. 2. The uniform basis is the unadjusted basis of the entire property determined immediately after the decedent's death. The proper measure of gain or loss resulting from a sale or other disposition of an interest in property acquired from a decedent is so much of the increase or decrease in the value of the entire property as is reflected in such sale or other disposition. Hence, in ascertaining the basis of a life interest, remainder interest, or other interest which is sold or otherwise disposed of, the uniform basis rule contemplates that proper adjustments will be made to reflect the change in relative value of the interests on account of the passage of time. Where a remainder interest is subject to a life interest in one person only, the factors set forth in the table which appears at the end of this subparagraph shall be used in determining the basis of the life interest or the remainder interest in the property at the time such interest is sold. The basis of the life interest or the remainder interest is computed by multiplying the uniform basis (adjusted to the time of the sale) by the appropriate factor. In the case of the sale of a life interest or a remainder interest, the factor used is the factor which appears in the life interest or the remainder interest column of the table opposite the age (at the time of the sale) of the person at whose death the life interest will terminate.

Age of measuring life	Factor for life interest	Factor for remainder interest
21	0.78203	0.21797
22	.77576	.22424
23	.76930	.23070
24	.76266	.23734
25	.75582	.24418
26	.74880	.25120
27	.74157	.25843
28	.73416	.26584
29	.72653	.27347
30	.71871	.28129
31	.71068	.28932
32	.70245	.29755
33	.69401	.30599
34	.68536	.31464
35	.67650	.32350
36	.66743	.33257

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Age of measuring life	Factor for life interest	Factor for remainder interest
37	.65815	.34185
38	.64867	.35133
39	.63898	.36102
40	.62908	.37092
41	.61899	.38101
42	.60869	.39131
43	.59820	.40180
44	.58751	.41249
45	.57664	.42336
46	.56559	.43441
47	.55436	.44564
48	.54297	.45703
49	.53141	.46859
50	.51970	.48030
51	.50785	.49215
52	.49587	.50413
53	.48377	.51623
54	.47157	.52843
55	.45926	.54074
56	.44688	.55312
57	.43442	.56558
58	.42191	.57809
59	.40936	.59064
60	.39679	.60321
61	.38422	.61578
62	.37165	.62835
63	.35911	.64089
64	.34663	.65337
65	.33420	.66580
66	.32186	.67814
67	.30962	.69038
68	.29750	.70250
69	.28552	.71448
70	.27370	.72630
71	.26205	.73795
72	.25059	.74941
73	.23934	.76066
74	.22831	.77169
75	.21752	.78248
76	.20698	.79302
77	.19670	.80330
78	.18671	.81329
79	.17700	.82300
80	.16759	.83241

In cases in which the value of an interest cannot be determined from the above table, for example, cases in which the

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interest to be valued is dependent upon the continuation or termination of more than one life, or there is a term-certain concurrent with one or more lives, the factor is to be computed upon the basis of the Makehamized mortality table and interest at the rate of 3½ percent a year, compounded annually. This table appears as Table 38 of United States Life Tables and Actuarial Tables 1939-1941, published by the United States Department of Commerce, Bureau of the Census.

(2) The application of this section may be illustrated by the following example:

Example. Improved realty having a fair market value of $20,000 at the date of the decedent's death on January 1, 1956, is devised to A for life, with remainder over to B. On January 1, 1960, A sells his life interest for $12,500. During each of the years 1956-59, inclusive, A was allowed a deduction of $300 for depreciation. Thus, the adjusted uniform basis of the property is $18,800 ($20,000 minus $1,200 depreciation). At the time of the sale, A was 39 years of age. The life factor to be used here is 0.63898. The portion of the uniform basis (adjusted to the time of the sale) assigned to A's life interest is $12,012.82 (0.63898 x $18,800). A's gain on the sale is $487.18 ($12,500 — 12,012.82).

2014 (4)-6 SPECIAL RULE FOR ADJUSTMENTS TO BASIS WHERE PROPERTY IS ACQUIRED FROM A DECEDENT PRIOR TO HIS DEATH.

(a) In General. (1) The basis of property described in M.S.A. 290.14 (4) which is acquired from a decedent prior to his death shall be adjusted for depreciation, obsolescence, amortization, and depletion allowed the taxpayer on such property for the period prior to the decedent's death. Thus, in general, the adjusted basis of such property will be its fair market value at the decedent's death, less the amount allowed (determined with regard to M. S. A. 290.09, Subd. 7 and 8) to the taxpayer as deductions for exhaustion, wear and tear, obsolescence, amortization and depletion for the period held by the taxpayer prior to the decedent's death. The deduction allowed for a taxable year in which the decedent dies shall be an amount properly allocable to that part of the year prior to his death. For a discussion of the basis adjustment required where property is held in trust, see paragraph (c) of this section.

(2) Where property coming within the purview of subparagraph (1) of this paragraph was held by the decedent and his surviving spouse as tenants by the entirety or as joint tenants with right of survivorship, and joint income tax returns were filed by the decedent and the surviving spouse in which the deductions referred to in subparagraph (1) were taken, there shall be allocated to the surviving spouse's interest in the property

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that proportion of the deductions allowed for each period for which the joint returns were filed which her income from the property bears to the total income from the property.

(3) The application of this paragraph may be illustrated by the following examples:

Example (1). The taxpayer acquired income-producing property by gift on January 1, 1956. The property had a fair market value of $50,000 on the date of the donor's death, January 1, 1958, and was included in his gross estate for Minnesota inheritance tax purposes at that amount for inheritance tax purposes as a transfer in contemplation of death. Depreciation in the amount of $750 per year was allowable for each of the taxable years 1956 and 1957. However, the taxpayer claimed depreciation in the amount of $500 for each of these years (resulting in a reduction in his taxes) and his income tax returns were accepted as filed. The adjusted basis of the property as of the date of the decedent's death is $49,000 ($50,000, the fair market value at the decedent's death, less $1,000, the total of the amounts actually allowed as deductions).

Example (2). On July 1, 1956 H purchased for $30,000 income-producing property which he conveyed to himself and W, his wife, as joint tenants. Each spouse was entitled to one-half of the income therefrom. H died on January 1, 1959, at which time the fair market value of the property was $40,000. The entire value of the property was included in H's gross estate for Minnesota inheritance tax purposes. H and W filed joint income tax returns for the years 1956 and 1957, and 1958. The total depreciation allowance for the year 1956 was $500 and for each of the other years 1957 and 1958 was $1,000. One-half of the $2,500 depreciation will be allocated to W. The adjusted basis of the property in W's hands of January 1, 1959, was $38,750 ($40,000, value on the date of H's death, less $1,250, depreciation allocated to W for periods before H's death).

(b) Multiple Interests In Property Described In M.S.A. 290.14 (4) (e) And Acquired From A Decedent Prior To His Death. (1) Where more than one person has an interest in property described in M.S.A. 290.14 (4) (e) which was acquired from a decedent before his death, the basis of such property and of each of the several interests therein shall, in general, be determined and adjusted in accordance with the principles contained in 2014 (4)-4 and 2014 (4)-5, relating to the uniformity of basis rules. Application of these principles to the determination of basis under M.S.A. 290.14 (4) (e) is shown in the remaining subparagraphs of this paragraph in connection with certain commonly encountered situations involving multiple interests in property acquired from a decedent before his death.

(2) Where property is acquired from a decedent before his death, and the entire property is subsequently included in the

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decedent's gross estate for Minnesota inheritance tax purposes, the uniform basis of the property, as well as the basis of each of the several interests in the property, shall be determined by taking into account the basis adjustments required by M.S.A. 290.14 (4) owing to such inclusion of the entire property in the decedent's gross estate for Minnesota inheritance tax purposes. For example, suppose that the decedent transfers property in trust, with a life estate to A, and the remainder to B or his estate. The transferred property consists of 100 shares of the common stock of X Corporation, with a basis of $10,000 at the time of the transfer. At the time of the decedent's death the value of the stock is $20,000. The transfer is held to have been made in contemplation of death and the entire value of the trust is included in the decedent's gross estate for Minnesota inheritance tax purposes. Under M.S.A. 290.14 (4), the uniform basis of the property in the hands of the trustee, the life tenant, and the remainderman, is $20,000. If immediately prior to the decedent's death, A's share of the uniform basis of $10,000 was $6,000, and B's share was $4,000, then, immediately after the decedent's death, A's share of the uniform basis of $20,000 is $12,000, and B's share is $8,000.

(c) Adjustments For Deductions Allowed Prior To The Decedent's Death. (1) As stated in paragraph (a), M.S.A. 290.14 (4) (e) requires a reduction in the uniform basis of property acquired from a decedent before his death for certain deductions allowed in respect of such property during the decedent's lifetime. In general, the amount of the reduction in basis required by M.S.A. 290.14 (4) (e) shall be the aggregate of the deductions allowed in respect of the property, but shall not include deductions allowed in respect of the property to the decedent himself. In cases where, owing to the operation of the inheritance tax, only a part of the value of the entire property is included in the decedent's gross estate, for Minnesota inheritance tax purposes, the amount of the reduction required by M.S.A. 290.14 (4) (e) shall be an amount which bears the same relation to the total of all deductions (described in paragraph (a) of this section) allowed in respect of the property as the value of the property included in the decedent's gross estate, for Minnesota inheritance tax purposes bears to the value of the entire property.

(2) The application of this paragraph may be illustrated by the following examples:

Example (1). The decedent creates a trust to pay the income to A for life, remainder to B or his estate. The property transferred in trust consists of an apartment building with a basis of $50,000 at the time of the transfer. The decedent dies 2 years after the transfer is made and the gift is held to have been made in contemplation of death. Depreciation on the property was allowed in the amount of $1,000 annually. At the time of the de-

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cedent's death the value of the property is $58,000. The uniform basis of the property in the hands of the trustee, the life tenant, and the remainderman, immediately after the decedent's death is $56,000 ($58,000, fair market value of the property immediately after the decedent's death, reduced by $2,000, deductions for depreciation allowed prior to the decedent's death).

Definitions.

For the purposes of regulation 2014 (4) the phrase, "gross estate for Minnesota inheritance tax purposes", shall mean; all probate and non-probate assets of the decedent, which are subject to inheritance tax or would be subject to such tax were it not for exemptions.

2014 (5) PROPERTY ACQUIRED THROUGH CERTAIN EXCHANGES.

(a) **Property acquired upon a tax-free exchange.** In the case of an exchange, after December 31, 1932, of property solely for the type described in M.S.A. 290.13, Subd. 1 and Subd. 2, if no part of the gain or loss was recognized under the law applicable to the year in which the exchange was made, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer on the date of the exchange.

If, on an exchange, after December 31, 1932, of properties of the type indicated in M.S.A. 290.13, Subd. 1, gain to the taxpayer was recognized under the provisions of M.S.A. 290.13, Subd. 2, or Subd. 3 or a similar provision of the 1933 Act, on account of the receipt of money in addition in the transaction, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange) decreased by the amount of money received and increased by the amount of gain recognized on the exchange.

If, upon an exchange of properties of the type described in M.S.A. 290.13, Subd. 1, there was received by the taxpayer in addition other property (not permitted to be received without the recognition of gain) and money, and gain from the transaction was recognized as required under M.S.A. 290.13, Subd. 2 or Subd. 3, or a similar provision of the 1933 Act, the basis (adjusted to the date of the exchange) of the property transferred by the taxpayer, decreased by the amount of money received and increased by the amount of gain recognized must be apportioned to and is the basis of the properties (other than money) received on the exchange for the purpose of the allocation of such basis to the properties received, there must be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

M.S.A. 290.13, Subd. 4 and a similar provision of the 1933 Act, provide that no loss may be recognized on an exchange of

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properties of a type described in M.S.A. 290.13, Subd. 1, although the taxpayer receives other property or money from the transaction.

(b) **Property acquired in an exchange transaction on or after January 1, 1933.** The basis for property acquired in a transaction involving neither loss nor gain under M.S.A. 290.13 is the same as it would be if the taxpayer were disposing of the property exchanged. The adjustments to the loss and gain basis shall include those which the taxpayer should have been required to make were he disposing of the property exchanged. (See M.S.A. 290.12.)

Transactions of this nature are treated as though the identity of the original property remained constant, its form alone changing as a result of the substitution of one kind of property for another of similar nature.

2014 (6) PROPERTY ACQUIRED IN WASH SALES TRANSACTIONS ON OR AFTER JANUARY 1, 1933.

The basis of property acquired in wash sale transactions is the same as in the case of the stock or securities disposed of, except that it shall be increased by the excess of the repurchased price of the stock or securities over the sale price of the original property, or decreased by the excess of the sale price of the original property over the repurchased price. For example, if an individual owns a share of stock for which he paid $100, and disposes of such stock on December 31st for $90, and within thirty days thereafter repurchases a share of the same kind of stock at a cost of $80, he would be denied a deduction or the loss of $10 sustained on the sale of the original share. When the taxpayer disposes of the new share the transaction is treated as though he were selling the property originally owned, except that the basis of the original property must be decreased by $10, the amount of the excess of the sale price of the original stock over the repurchase price.

The adjustments in the case of the sale of property acquired in a wash sale transaction shall include those which the taxpayer should have been required to make were he selling or otherwise disposing of the property sold in any such transaction.

2014 (8) PROPERTY ON WHICH LESSEE HAS MADE IMPROVEMENTS.

In any case in which a lessee of real property has erected buildings or made other improvements upon the leased property and the lease is terminated by forfeiture or otherwise resulting in the realization by such lessor of income which, were it not

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for the provisions of M.S.A. 290.08, Subd. 14, would be includible in gross income of the lessor, the amount so excluded from gross income shall not be taken into account in determining the basis or the adjusted basis of such property or any portion thereof in the hands of the lessor. If, however, in any taxable year beginning prior to January 1, 1943, there has been included in the gross income of the lessor an amount representing any part of the value of such property attributable to such buildings or improvements, the basis of each portion of such property shall be properly adjusted for the amount so included in gross income.

For example, A leased in 1933 to B for a period of twenty-five years unimproved real property and in accordance with the terms of the lease B erected a building on the property. It was estimated that upon the expiration of the lease that the building would have a depreciatd value of $50,000, which value the lessor elected to report (beginning in 1934) as income under the term of the lease. In 1943 B forfeits the lease. The amount of $18,000 reported as income by A during the years 1934 to 1942, both years inclusive, shall be added to the basis of the property represented by the improvements in the hands of A. If in such case A did not report during the period of the lease any income attributable to the value of the building erected by the lessee and the lease was forfeited in 1940 with the building worth $75,000, such amount, having been included in gross income under the Law applicable to that year, is added to the basis of the property represented by the improvements in the hands of A.

2015 BASIS FOR DETERMINING GAIN OR LOSS—PROPERTY ACQUIRED PRIOR TO JANUARY 1, 1933.

(a) **General rule.** In general, "cost" (as defined below) is used as the basis to determine the gain or loss resulting from the sale or other disposition of property acquired prior to January 1, 1933.

(1) With respect to property acquired by purchase, "cost" is the total consideration paid for the property.

(2) With respect to property acquired by gift, "cost" is deemed to be the basis which would be used if the property were being disposed of by the last preceding owner not acquiring the property by gift. (See Reg. 2014 (2).)

(3) With respect to property acquired through an inter vivos transfer in trust, "cost" is deemed to be the same as if the property were being disposed of by the grantor. (See Reg. 2014 (3).)

(4) With respect to property acquired by devise, bequest, or inheritance, or by the estate of a decedent from such decedent, "cost" is the fair market value of the property at the

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date of the decedent's death, regardless of the time when the taxpayer comes into possession or enjoyment of the property. (See Reg. 2014 (4).)

In all cases where "cost" is used as the basis for determining gain or loss, proper adjustments must be made in accordance with the provisions of M.S.A. 290.12 and Reg. 2012 (2) (a) and (b).

For determining gain from the sale or other disposition of property acquired before January 1, 1933, the taxpayer, in lieu of the basis described above, has the option of using the fair market value of the property as of January 1, 1933, where such value can be established. If this basis is used, proper adjustments must be made for the period from January 1, 1933, to the date of the sale. (See M.S.A. 290.12 and Reg. 2012 (2) (a) and (b).)

For determining loss from the sale or other disposition of property acquired before January 1, 1933, the taxpayer does not have the option of using the fair market value as of January 1, 1933, as a basis. For determining loss, cost as defined at paragraphs (1), (2), (3), and (4) of this regulation must be used.

The following example illustrates the rule:

Cost	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
January 1, 1933 value	15,000	8,000	15,000	8,000	3,000	15,000
Selling price	20,000	20,000	5,000	5,000	5,000	12,000
Taxable gain or loss	5,000	10,000	(5,000)	(5,000)	(5,000)	0

(b) **Fair market value defined.** The "fair market value" of property is the amount which would induce a willing seller to sell and a willing buyer to purchase, both having reasonable knowledge of the facts, and neither being obliged to buy or sell.

The determination of the fair market value of property as of January 1, 1933, or any other basic date, is a question of fact to be established by competent evidence. It has been recognized that men of equally wise judgment will differ widely in their opinion as to the fair market value merely because there may be a considerable divergence of opinion as to its value.

2016 (1) BASIS FOR DEPRECIATION.

M.S.A. 290.16 provides that the basis upon which exhaustion, wear, tear, obsolescence or depreciation are to be allowed in respect of any property shall be the same as provided in M.S.A. 290.14 and 290.15 for the purpose of computing the loss or gain on the sale or other disposition of property. However, if depreciation is computed and allowed on the basis of fair market value as of January 1, 1933, and it later appears when the asset is sold that cost must be used as the loss or gain basis, adjustments must

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then be made for excessive depreciation in prior years in the amount that the depreciation of which was allowed exceeds that depreciation allowable when computed on the basis of cost.

2016 (3) DEFINITION OF TERMS.

(a) **Capital assets.** The term "capital assets" includes all classes of property not specifically excluded by M.S.A. 290.16, Subd. 3 (1).

These specific exclusions are:

(1) Stock in trade or other property of a kind which would be properly includible in the inventory of the taxpayer if on hand at the close of the taxable year.

(2) Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. This includes only property sold in the ordinary course of the taxpayer's trade or business. Unusual or extraordinary sales are excluded from this classification. A sale made in the ordinary course of business implies an effort directed chiefly at securing a sale of a product similar sales of which constitute a substantial part of an individual's commercial activities.

(3) Property used in a trade or business of a character which is subject to the allowance for depreciation provided in M.S.A. 290.09, Subd. 7 or amortization allowances provided in M.S.A. 290.09, Subd. 11. Property is considered of a character subject to the allowance for depreciation even though such property has a zero gain or loss basis. For example, livestock raised by a farmer and used in his trade or business. Property held for the production of income but not used in a trade or business of the taxpayer is not excluded from the term "capital assets" even though of a character subject to the allowance for depreciation.

(4) Real property used in a taxpayer's trade or business.

(5) For all taxable years beginning after December 31, 1954, accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in M.S.A. 290.16, Subd. 3 (1) (a).

(b) **Short term.** As used in this regulation, the term "short term" applies to sales or exchanges of capital assets held for not more than 6 months.

(c) **Long term.** As used in this regulation, the term "long term" applies to sales or exchanges of capital assets held for more than 6 months.

(d) **Short-term capital loss.** The term "short-term capital loss" means a loss from the sale or exchange of a capital asset held for not more than 6 months to the extent such loss is taken

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into account in computing net income. Losses which are not allowable deductions from gross income are not taken into account in computing net income and are excluded from the term "short-term capital loss" even though the asset was held for not more than 6 months.

(e) **Net capital gain.** Net capital gain is the sum of (1) the gains from sales or exchanges of capital assets, plus (2) net income of the taxpayer computed without regard to gains or losses from sales or exchanges of capital assets, or $1,000.00 whichever is smaller, minus (3) losses from sales or exchanges.

The purpose of computing a net capital gain is to determine the amount of a carryover loss provided by subdivision 6 of M.S.A. 290.16. The computation of a net capital gain has no effect on the taxable net income.

For example, a taxpayer sustained a long-term capital loss from the sales or exchanges of capital assets held for more than 6 months of $10,000.00, and realized a short-term gain, that is, from the sales or exchanges of capital assets held for not more than 6 months of $20,000.00, and a long-term gain of $40,000.00. His net income, that is, the gross income minus the allowable deductions exclusive of capital gains or losses was $1,000.00. A net capital gain was computed as follows:

Short-term gain	$20,000.00
Long-term gain	40,000.00
Net income	1,000.00
Total	$61,000.00
Less the long-term loss	10,000.00
Net capital gain	$51,000.00

A taxpayer may have a net capital gain even though he had no gains or losses from the sales or exchanges of capital assets during the year. For example, a taxpayer had a net income of $1,000.00. Since this net income is the excess of the sum of the gains from the sales or exchanges of capital assets, plus the net income of $1,000.00, over the losses from the sales or exchanges by the amount of $1,000.00, the net income of $1,000.00 is the taxpayer's net capital gain.

(f) **Net capital loss.** A net capital loss is the excess of the losses from the sales or exchanges of capital assets over the

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net income computed without regard to gains or losses from the sales or exchanges of capital assets, or $1,000.00 whichever is smaller. The amount carried forward as a short-term loss is excluded from the computation of a net capital loss. Only the losses from the sales or exchanges of the taxable year are considered in this computation. The purpose of computing a net capital loss is to compute the carryover provided in subdivision 6 of M.S.A. 290.16.

The following is an illustration of the computation of a net capital loss. The taxpayer had a short-term loss, that is, from the sale or exchange of capital assets held for not more than 6 months of $20,000.00 and a long-term loss, of $20,000.00. His net income for the year, that is, the gross income in excess of his allowable deductions without considering capital gains or losses was $1,000.00. His short-term capital gain for the year was $5,000.00. The net capital loss is computed as follows:

Short-Term Loss		$20,000.00
Long-Term Loss		20,000.00
Total		$40,000.00
Short-Term Capital Gain	$5,000.00	
Net Income	1,000.00	6,000.00
Net Capital Loss		$34,000.00

The net capital loss may be carried forward to the five succeeding taxable years.

2016 (4) DEDUCTION FOR CAPITAL GAINS.

In computing gross income, adjusted gross income, net income, net capital gain, and net capital loss, 100 per cent of any gain or loss upon the sale or exchange of a capital asset shall be taken into account regardless of the period for which the capital asset has been held. Nevertheless, for the purposes of section 290.16, Subd. 4 the net short-term capital gain or loss and the net long-term capital gain or loss must be separately computed, in order that it may be determined whether or not the deduction provided for in Subd. 4 is allowable. Under this subdivision, if the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess is allowable as a deduction from gross income.

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For the purposes of computing the deduction allowable under M.S.A. 290.16, Subd. 4 in the case of an estate or trust any capital gains, whether short-term or long-term, which under any provisions of chapter 290 is includible in the gross income of the beneficiaries of said estate or trust, must be excluded in determining whether or not the estate or trust is entitled to this deduction.

2016 (5) LIMITATION OF LOSSES.

Losses from the sale or exchange of capital assets shall be allowed as a deduction only to the extent of the gains from such sales or exchanges, plus the taxable income of the taxpayer, or $1,000, whichever is smaller. An individual who is a member of a partnership may offset against his capital gains and losses sustained separately from the operations of the partnership, his distributive share of the capital gains or losses of the partnership. Capital gains and losses of the partnership are thus carried forward to the partner's respective individual returns, and the capital loss limitation of $1,000, or net income whichever is smaller, is not applied to the partnership as a separate legal entity.

A mortgagor's loss on a foreclosure sale on his mortgaged property is subject to the limitation of $1,000, or net income, whichever is smaller. The event fixing the loss is the foreclosure sale.

An involuntary transfer of the title to land to the state for unpaid taxes by a foreclosure of the tax lien constitutes a sale or exchange within the meaning of M.S.A. 290.16. A loss on such a transaction is subject to the limitations of $1,000 or net income, whichever is smaller unless the property was used in the trade or business and held for not more than 6 months, or held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Husband and wife may each claim a capital loss of $1,000, or net income, whichever is smaller, in the event separate returns are filed by them. In filing separate returns only the gain or loss resulting from the sale of the property of each spouse may be included in the separate returns. If husband and wife filed a joint return, they are considered to be one taxpayer. Accordingly, even though certain property may be owned by one spouse

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separately, the capital gain or loss will be computed jointly, just as though the husband and wife were one taxpayer, and only one $1,000, or net income whichever is smaller, capital loss deduction may be taken in the joint return.

2016 (8)-1 DETERMINATION OF PERIOD FOR WHICH CAPITAL ASSETS ARE HELD.

(a) The holding period of property received in an exchange by a taxpayer includes the period for which the property which he exchanged was held by him, if the property received has the same basis in whole or in part for determining gain or loss in the hands of the taxpayer as the property exchanged. However, this rule shall apply, in the case of exchanges after March 1, 1954, only if the property exchanged was at the time of the exchange a capital asset in the hands of the taxpayer or property used in his trade or business as defined in M.S.A. 290.16, Subd. 9 (1). For the purposes of this paragraph the term "exchange" includes the following transactions: (1) An involuntary conversion described in M.S.A. 290.13, Subd. 5, (2) a distribution to which M.S.A. 290.136, Subd. 3 (or so much of M.S.A. 290.136, Subd. 4 as relates to M.S.A. 290.136, Subd. 3) applies. Thus, if property acquired as the result of a compulsory or involuntary conversion of other property of the taxpayer has under M.S.A. 290.13, Subd. 5 (3) (D), the same basis in whole or in part in the hands of the taxpayer as the property so converted, its acquistion is treated as an exchange and the holding period of the newly acquired property shall include the period during which the converted property was held by the taxpayer. Thus, also, where stock of a controlled corporation is received by a taxpayer pursuant to a distribution to which M.S.A. 290.136, Subd. 3 (or so much of M.S.A. 290.136, Subd. 4 as relates to M.S.A. 290.136, Subd. 3) applies, the distribution is treated as an exchange and the period for which the taxpayer has held the stock of the controlled corporation shall include the period for which he held the stock of the distributing corporation with respect to which such distribution was made.

(b) The holding period of property in the hands of a taxpayer shall include the period during which the property was held by any other person, if such property has the same basis in whole or in part in the hands of the taxpayer for determining gain or loss from a sale or exchange as it would have in the hands of such other person.

(c) If the acquisition of stock or securities resulted in the nondeductibility of the loss from the sale or other disposition of sub-

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stantially identical stock or securities, the holding period of the newly acquired securities shall include the period for which the taxpayer held the securities with respect to which the loss was not allowable.

(d) The period for which the taxpayer has held stock, or stock subscription rights, received on a distribution shall be determined as though the stock dividend, or stock right, as the case may be, were the stock in respect of which the dividend was issued if the basis for determining gain or loss upon the sale or other disposition of such stock dividend or stock right is determined under M.S.A. 290.131, Subd. 7.

(e) The period for which the taxpayer has held stock or securities issued to him by a corporation pursuant to the exercise by him of rights to acquire such stock or securities from the corporation will, in every case and whether or not the receipt of taxable gain was recognized in connection with the distribution of the rights, begin with and include the day upon which the rights to acquire such stock or securities were exercised. A taxpayer will be deemed to have exercised rights received from a corporation to acquire stock or securities therein where there is an expression of assent to the terms of such rights made by the taxpayer in the manner requested or authorized by the corporation.

(f) The period for which the taxpayer has held a residence, the acquisition of which resulted under the provisions of M.S.A. 290.13, Subd. 9 in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, shall include the period for which such other residence has been held as of the date of such sale or exchange. See 2013 (9). For purposes of this paragraph, the term "sale or exchange" includes an involuntary conversion described in M.S.A. 290.13, Subd. 5.

(g) If a taxpayer accepts delivery of a commodity in satisfaction of a commodity futures contract, the holding period of the commodity shall include the period for which the taxpayer held the commodity futures contract, if such futures contract was a capital asset in his hands.

(h) If shares of stock in a corporation are sold from lots purchased at different dates or at different prices and the identity of the lots cannot be determined, the rules prescribed by the regulations under section 1012 of the Internal Revenue Code of 1954 for determining the cost or other basis of such stocks so sold or transferred shall apply for the purpose of determining the holding period of such stock.

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2016 (9) GAINS AND LOSSES FROM INVOLUNTARY CONVERSIONS AND FROM SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN TRADE OR BUSINESS.

(a) **In general.** The recognized gains and losses described in subdivisions (1) and (2) of this paragraph shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. The gains and losses referred to in this paragraph are the following:

(1) Gains and losses from the sale, exchange, or involuntary conversion of "property used in the trade or business," as that term is defined in paragraph (b) of this regulation, and

(2) Gains and losses from the involuntary conversion of capital assets held for more than six months.

(b) **Property used in the trade or business.—**

(1) **Defined.** The term "property used in the trade or business" means:

(A) Property used in the trade or business of a character which is subject to the allowance for depreciation provided in M.S.A. 290.09, Subd. 7, and which has been held for more than six months;

(B) Real property used in the trade or business, and which has been held for more than six months, and which is not

(i) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or

(ii) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(C) Livestock, regardless of age, held by the taxpayer for draft, breeding or dairy purposes, and held by him for twelve months or more from the date of acquisition (but see paragraph (b) (2) of this regulation).

The following types of property do not come within the term "property used in the trade or business":

(A) Property held for less than six months regardless of whether or not used in a trade or business;

(B) Inventory property;

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(C) Property held primarily for sale in the ordinary course of a trade or business;

(D) Poultry (but see paragraph (b) (2) of this regulation);

(E) Property which is of the character subject to the allowance for depreciation, and which has been held for more than six months, but which has not been used in the trade or business.

(2) **Livestock and poultry.** If livestock is sold, exchanged, or involuntarily converted such livestock, other than poultry, qualifies as "property used in the trade or business" if it was

(i) held by the taxpayer for draft, breeding, or dairy purposes, and

(ii) held by the taxpayer for twelve months or more from the date of acquisition.

Poultry sold, exchanged, or involuntarily converted does not qualify as "property used in the trade or business".

(c) **Involuntary conversion.** For the purpose of this regulation, the "involuntary conversion" of property is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof. Losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there was a conversion of the property into money or other property. For example, if a capital asset held for more than six months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under M.S.A. 290.16, Subd. 9.

(d) **Computation.** In determining whether the gains described in paragraph (a) of this regulation exceed the losses described therein, such gains and losses are taken into account in full, that is, 100 percent of such gains and losses is taken into account. The provisions of M.S.A. 290.16, Subd. 5 limiting the deduction of capital losses are not applicable to exclude any losses from the computations under M.S.A. 290.16, Subd. 9.

The following is an illustration of the computation of the excess of gains over losses:

	GAINS	LOSSES
Gain on sale of machinery used in a trade or business held for more than six months	$2,000.00	

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Gain on building used in a trade or business held for more than six months....	6,000.00	
Gain on land used in a trade or business held for more than six months.....	1,500.00	
Loss on a damaged truck used in a trade or business held for more than six months		$ 500.00
Fire loss on a warehouse used in a trade or business held for more than six months		1,000.00
Theft loss of a diamond ring held for more than six months		150.00
Storm damage on personal residence held for more than six months		2,000.00
	$9,500.00	$3,650.00

Excess of gains over losses, $5,850.00.

2016 (14) CANCELLATION OF LEASE OR DISTRIBUTOR'S AGREEMENT.

(a) In General. M.S.A. 290.16, Subd. 14 provides that proceeds received by lessees or distributors from the cancellation of leases or of certain distributorship agreements are considered as amounts received in exchange therefor. M.S.A. 290.16, Subd. 14 applies to leases of both real and personal property. Distributorship agreements to which M.S.A. 290.16, Subd. 14 applies are described in paragraph (c) of this section. M.S.A. 290.16, Subd. 14 has no application in determining whether or not a cancellation not qualifying under that section is a sale or exchange. Further, M.S.A. 290.16, Subd. 14 has no application in determining whether or not a lease or a distributorship agreement is a capital asset, even though its cancellation qualifies as an exchange under M.S.A. 290.16, Subd. 14.

(b) Definition Of "Cancellation". The term "cancellation" of a lease or a distributor's agreement, as used in M.S.A. 290.16, Subd. 14, means a termination of all the contractual rights of a lessee or distributor with respect to particular premises or a particular distributorship, other than by the expiration of the lease or agreement in accordance with its terms. A payment made in good faith for a partial cancellation of a lease or a distributorship agreement is recognized as an amount received for cancellation under M.S.A. 290.16, Subd. 14 if the cancellation relates to a severable economic unit, such as a portion of the premises covered by a lease, a reduction in the unexpired term of a lease or distributorship agreement, or a distributorship in one of several areas or of one of several products. Payments made for

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other modifications of leases or distributorship agreements, however, are not recognized as amounts received for cancellation under M.S.A. 290.16, Subd. 14.

(c) Amounts Received Upon Cancellation Of A Distributorship Agreement. M.S.A. 290.16, Subd. 14 applies to distributorship agreements only if they are for marketing or marketing and servicing of goods. It does not apply to agreements for selling intangible property or for rendering personal services as, for example, agreements establishing insurance agencies or agencies for the brokerage of securities. Further, it applies to a distributorship agreement only if the distributor has made a substantial investment of capital in the distributorship. The substantial capital investment must be reflected in physical assets such as inventories of tangible goods, equipment, machinery, storage facilities, or similar property. An investment is not considered substantial for purposes of M.S.A. 290.16, Subd. 14 unless it consists of a significant fraction or more of the facilities for storing, transporting, processing, or otherwise dealing with the goods distributed, or consists of a substantial inventory of such goods. The investment required in the maintenance of an office merely for clerical operations is not considered substantial for purposes of this section. Furthermore, M.S.A. 290.16, Subd. 14 shall not apply unless a substantial amount of the capital or assets needed for carrying on the operations of a distributorship are acquired by the distributor and actually used in carrying on the distributorship at some time before the cancellation of the distributorship agreement. It is immaterial for the purposes of M.S.A. 290.16, Subd. 14 whether the distributor acquired the assets used in performing the functions of the distributorship before or after beginning his operations under the distributorship agreement. It is also immaterial whether the distributor is a retailer, wholesaler, jobber, or other type of distributor. The application of this paragraph may be illustrated by the following examples:

Example (1). Taxpayer is a distributor of various food products. He leases a warehouse including cold storage facilities and owns a number of motor trucks. In 1959 he obtains the exclusive rights to market certain frozen food products in his State. The marketing is accomplished by using the warehouse and trucks acquired before he entered into the agreement and entails no additional capital. Payments received upon the cancellation of the agreement are treated under M.S.A. 290.16, Subd. 14 as though received upon the sale or exchange of the agreement.

Example (2). Assume that the taxpayer in example (1) entered into an exclusive distributorship agreement with the producer under which the taxpayer merely solicits orders through his staff of salesmen, the goods being shipped direct to the pur-

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chasers. Payments received upon the cancellation of the agreement would not be treated under M.S.A. 290.16, Subd. 14 as though received upon the sale or exchange of the agreement.

Example (3). Taxpayer is an exclusive distributor for M city of certain frozen food products which he distributes to frozen-food freezer and locker customers. The terms of his distributorship do not make it necessary for him to have any substantial investment in inventory. Taxpayer rents a loading platform for a nominal amount, but has no warehouse space. Orders for goods from customers are consolidated by the taxpayer and forwarded to the producer from time to time. Upon receipt of these goods taxpayer allocates them to the individual orders of customers and delivers them immediately by truck. Although it would require a fleet of fifteen or twenty trucks to carry out this operation, the distributor uses only one truck of his own and hires cartage companies to deliver the bulk of the merchandise to the customers. Payments received upon the cancellation of the distributorship agreement in such a case would not be considered received upon the sale or exchange of the agreement under M. S. A. 290.16, Subd. 14 since the taxpayer does not have facilities for the physical handling of more than a small fraction of the goods involved in carrying on the distributorship and, therefore, does not have a substantial capital investment in the distributorship. On the other hand, if the taxpayer had acquired and used a substantial number of the trucks necessary for the deliveries to his customers, payments received upon the cancellation of the agreement would be considered received in exchange therefore under M.S.A. 290.16, Subd. 14.

2017 (1) COMPENSATION FOR LABOR OR PERSONAL SERVICES.

(a) **General rule.** Compensation for labor or personal services, including income from a business consisting principally of the performance of personal or professional services, shall be assigned as follows:

(1) If the taxpayer is a resident or domestic taxpayer, the entire amount of such income shall be assigned to this State;

(2) If the taxpayer is a non-resident, the income from such sources shall be assigned to this State if, and to the extent that, the labor or services are performed within this State and shall include the distributive share of partnership income to the extent that said share is attributable to personal or professional services performed within this State.

(3) All other amounts of such income shall be treated as income from sources outside of this State.

(b) **Resident or domestic taxpayers.** All income derived from labor or personal services, professions or vocations by a

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resident or domestic taxpayer of the State of Minnesota is taxable even though the service was actually performed, in whole or in part, outside of the State.

Although an individual's residence and domicile are usually the same, this is not necessarily always the case. An individual may be residing during the entire taxable year without the State, but his domicile may still be within the State. If a taxpayer is a resident of this State, or if his domicile is in this State, he must assign all income from labor or personal services, professions or vocations to the State of Minnesota. For the definition of "resident", see M.S.A. 290.01, Subd. 7, and Reg. 2001 (7).

Example (1). The salary of a resident of Minnesota for services performed in Wisconsin is assignable to this State. (2) An individual whose domicile is in this State may actually reside outside of the State although not intending to give up his Minnesota domicile. Such an individual's income from personal services is assignable to this State. (3) Income derived from professional services by an attorney having a residence or domicile in Minnesota but practicing in Iowa is assignable to this State.

(c) **Stock brokerage or investment business.** The income of a stock broker or of an investment or financial business is not considered as derived from personal services in cases where stocks, bonds, or other property, whether tangible or intangible, constitute the stock in trade.

2017 (2) ASSIGNMENT OF INCOME TO MINNESOTA—INCOME FROM PROPERTY.

(a) **Income from tangible property.** Income and gains received from tangible property not employed in the business of the recipient shall be assigned to this State if such property has a situs within it.

Income and gains received from tangible property employed in the business of such recipient if such business consists principally of the holding of such property and the collection of the income and gains therefrom shall be assigned to this State if such property has a situs within it.

The term "tangible property" means corporeal property, either real or personal. Income from property may be derived through its sale, rental, or operation.

Real estate and tangible personal property have a situs in the state in which they are located. Income derived from the sale or use of such property follows its situs, regardless of the residence of the recipient. For instance, rent, less related expenses, received from tangible property situated in Minnesota, is assignable to this State regardless of the domicile of the recipient.

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No gain or loss from tangible property, not employed in a business, having a situs without Minnesota is assignable to this State. For instance, income derived from the operation of a gold mine located without Minnesota is not assignable to this State, nor is any loss therefrom deductible. This general rule applies in every case where the interest of the taxpayer is of a tangible nature.

The income from the operation of a farm is assigned to this State if the farm is located in this State and to other states if the farm is not located in this State. The operation of a farm includes the sale of products produced on the farm. The purchase of livestock for feeding purposes and subsequent resale is a part of the farming operations and the income is assignable to the state in which the farm is located. The income from the operation of a farm is assigned to the state in which the farm is located regardless of where the products produced on the farm are sold. The income which a non-resident receives from a farm located in this State is assignable to this State.

The income realized from the purchase and sale of farm products not raised on the vendor's farm is not income realized from the operation of a farm and is assigned to the state in which the sale is made.

The income from real estate or tangible personal property used in a trade or business where such trade or business does not consist principally of the holding of such property and the collection of the income and gains therefrom shall be apportioned according to the provisions of M.S.A. 290.19.

(b) **Income from intangible property.** The methods for assignment of income or gains from intangible personal property differ from those used for the assignment of income from tangible property. The income from intangible personal property ordinarily follows the domicile of the recipient except where such property is employed in the business of the taxpayer and such business does not consist principally of the holding of such property and the collection of the income and gains therefrom. In cases where stocks, bonds or other intangible property constitute the stock in trade, the income from trading in such intangible property is assignable to the state in which such business is conducted. (For definitions of "domicile" see M.S.A. 290.01, Subd. 7 and Reg. 2001 (7).)

Income or gains from intangible personal property not employed in the business of a corporation taxpayer taxable under the provisions of this Act shall be assigned to this State if the corporation has its legal domicile in this State or its commercial domicile in this State.

Income or gains from intangible personal property held in trust shall be assigned to this State, if the recipient of such in-

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come is domiciled within this State and if such income or gains would be taxable to such recipient under M.S.A. 290.22; or if the grantor of such trust is domiciled within this State and such income or gains would be taxable to such grantor under M.S.A. 290.28.

Intangible personal property includes stocks, bonds, mortgages, notes, accounts receivable, patents, copyrights, etc., and usually has no fixed situs separate from the domicile of the owner. However, intangible personal property employed in a business may, through integration, acquire a situs other than at the domicile of the owner.

Profits or losses on casual stock exchange transactions constitute taxable income or deductible loss to a person domiciled in Minnesota, regardless of where such transactions take place.

Income from royalties from patents should be distinguished from royalties from real estate or tangible personal property which follow the situs of the property.

While profit from the sale of real estate follows the situs of the property, the income from a contract for deed follows the domicile of the recipient. Interest received or gain realized by a person domiciled in Minnesota, on a mortgage secured by Wisconsin real estate is assignable to this State.

The income from intangible personal property used in a trade or business where such trade or business does not consist principally of the holding of such property and the collection of the income and gains therefrom shall be apportioned according to the provisions of M.S.A. 290.19.

Dividends received by a taxpayer domiciled in Minnesota from shares of stock in a corporation, wherever located, are assignable to this State.

Repealed, 8 SR 114 7-25-83

2017 (3) ASSIGNMENT OF INCOME TO MINNESOTA — INCOME FROM A TRADE OR BUSINESS CONDUCTED WHOLLY WITHIN OR WHOLLY WITHOUT THE STATE.

If a trade or business is conducted wholly within this State the income derived therefrom shall be assigned to this State. If the business is owned by natural persons the income imputable to the owner for his services and the use of his property therein shall be assigned to this State or other states or countries according to the assignment of the income from such trade or business. If the trade or business is conducted wholly without this State the income therefrom is not assignable to Minnesota.

The words "trade or business" as used in this regulation do not apply to business income in the form of compensation for

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labor or personal services or from a business consisting principally of the performance of personal or professional service.

Business transacted by Minnesota concerns in other states through traveling salesmen or correspondence is regarded as Minnesota business.

Where a Minnesota concern ships goods on consignment to a factor in another state, such goods to be sold by the factor, who pays the consignor after the goods are sold, such transaction is considered as Minnesota business.

Income derived from goods manufactured within and sold without the state may constitute Minnesota business.

Sales are considered to be made in Minnesota if made through, from or by offices, agencies, branches, or stores located within this State, regardless of the location of the purchaser or the destination of the goods sold. The fact that goods are shipped direct from a manufacturer outside the State of Minnesota to a customer outside the state, when such sale was made in Minnesota by a Minnesota concern, does not remove the transaction from classification as Minnesota business.

Income from mining operations conducted in Minnesota is assignable to this State; however, see M.S.A. 290.05, (2) which exempts certain income from mining operations.

Income derived from the conduct of construction projects, either by corporation, individuals in their individual capacity or as a partnership, is assignable to this State provided the project has a situs within this State.

2017 (4) ASSIGNMENT OF INCOME TO MINNESOTA — INCOME FROM A TRADE OR BUSINESS CONDUCTED PARTLY WITHIN AND PARTLY WITHOUT THE STATE.

In the case of a trade or business—except an insurance company or investment company—which is carried on partly within and partly without this State, the income therefrom shall be apportioned according to the provisions of M.S.A. 290.19. The income of an insurance company which operates partly within and partly without this State shall be apportioned according to the provisions of M.S.A. 290.35. The income of an investment company which operates partly within and partly without this State shall be apportioned according to the provisions of M.S.A. 290.36.

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2018 (1) DEDUCTIONS ALLOWABLE IN COMPUTING TAXABLE NET INCOME.

In computing taxable net income (except in so far as M.S.A. 290.19 is applicable) the extent to which deductions permitted by M.S.A. 290.09 will be allowed shall be determined as follows:

(a) **Business expenses.—**

(1) If the deductions permitted by M.S.A. 290.09 are connected with and allocable against the production or receipt of gross income assignable to this State, they are allowable in their entirety.

(2) M.S.A. 290.09 permits some deductions which are not connected with and allocable against the production or receipt of gross income assignable to Minnesota. If such deductions are connected with and allocable against the production or receipt of gross income assignable to some other state or country, they do not constitute an allowable deduction. The use of the term "connected with and allocable against" in the preceding sentence pertaining to other states or countries, is construed in a broad sense. For instance, if a Minnesota taxpayer owns real estate in another state, which at any given time is wholly unproductive of gross income, the absence of such gross income would not operate to classify the expenses of that property during its unproductive period as deductions not connected with the production of gross income assignable to other states. The fact that the gross income from such property (even though at present it offers no potentiality of gross income) would be assignable to some other state, if and when earned, is sufficient to render the expenses connected with such property totally assignable without Minnesota at any time.

(b) **Non-business expenses.** There are some deductions ordinarily allowable under the provisions of M.S.A. 290.09 which are not connected with and allocable against the production or receipt of gross income. Examples of such deductions are sickness and personal injury expenses, non-business interest, non-business losses and non-business bad debts. Such non-business deductions are allowable to the extent of the ratio which the taxpayer's adjusted gross income from sources within this State bears to his adjusted gross income from all sources. For example, a taxpayer having a total gross income of $10,000, $5,000 of which was assignable without Minnesota as business income earned in other states, would be allowed to claim as a deduction one-half of his nonbusiness deductions in the computation of his taxable net income assignable to this State. There is one exception to this rule, however, and that is in the case of taxes of the kind deductible under M.S.A. 290.09, Subd. 4. Such taxes are deductible in their entirety if paid to the State of Minnesota or any of its subdivisions authorized to impose such taxes.

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(c) **Gross income defined.** The term "gross income," as used in M.S.A. 290.18, is construed to mean (a) in the case of a business involving the sale of personal property, the gross profit, and (b) in all other cases, the gross earnings or receipts.

(d) **Federal Income and Excess Profits Taxes.** Federal Income and Excess Profits Taxes are deductible only in the year in which paid or withheld, and for the purpose of allocating such taxes to this State the following rules shall apply:

(1) Where the entire net income of a taxpayer, of the year for which the Federal Income and Excess Profits Taxes were assessed, arises from a trade or business carried on partly within and partly without this State, such taxes shall be allowed as a deduction from gross income, of the year in which such taxes are paid, in computing net income subject to apportionment.

(2) If, in the year for which the Federal Income and Excess Profits Taxes were assessed, a taxpayer has net income from a trade or business carried on partly within and partly without this State and, in addition, has nonapportionable income assignable to Minnesota or nonapportionable income not assignable to Minnesota, or both, such taxes connected with and allocable against the production or receipt of nonapportionable income assignable to Minnesota shall be deductible and such taxes connected with and allocable against the production or receipt of nonapportionable income not assignable to this State shall not be deductible. Federal Income and Excess Profits Taxes connected with and allocable against the production or receipt of apportionable income of the year for which such taxes were assessed, allowable as a deduction, shall be determined in accordance with the provisions of paragraph (1).

For the purpose of computing the portion of Federal Income and Excess Profits Taxes connected with and allocable against the production or receipt of nonapportionable income, the basis shall be the ratio of such nonapportionable income to income from all sources of the year for which such taxes were assessed, unless a specified ratio of Federal tax applied to part or all of such nonapportionable income in which case such rate shall be used.

(3) Federal Income and Excess Profits Taxes connected with and allocable against the production or receipt of income which is exempt or excluded from taxation under M.S.A. 290.05 or 290.08 shall not be allowed as a deduction. This computation shall be based upon the ratio of such exempt or excluded income to total income from all sources of the year for which such taxes were assessed.

(4) In cases where net income is permitted to be allocated to Minnesota on the basis of separate accounting, Federal Income and Excess Profits Taxes to be allowed as a deduction

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shall be determined by the ratio which such net income assigned to Minnesota bears to the total income from all sources of the year for which such taxes were assessed.

In any case where it appears that the foregoing formula does not fairly and properly allocate Federal Income and Excess Profits Taxes paid, the Commissioner may permit or require the use of other methods.

(e) **Application of M.S.A. 290.18, Subd. 1 (2).** The provisions of M.S.A. 290.18, Subd. 1 (2) apply to both resident and non-resident taxpayers. Taxpayers claiming deductions under this provision must furnish the Commissioner with sufficient information to enable him to determine the validity and correctness of such deductions.

2019 APPORTIONMENT OF NET INCOME OF BUSINESS CONDUCTED PARTLY WITHIN MINNESOTA.

(a) **Applicability of M.S.A. 290.19.** The formulae prescribed by the provisions of M.S.A. 290.19 shall be applied to the apportionable net income of a trade or business where the business carried on within this State is an integral part of a business carried on both within and without this State.

(b) **Apportionment of net income under M.S.A. 290.19, Subd. 1 (1).** If the business consists of the manufacture in Minnesota or within and without Minnesota of personal property and sale of said property within and without Minnesota the formula shall be as follows:

(1) Under M.S.A. 290.19, Subd. 1 (1) (a), (b), (c).

$$\frac{\text{Minn. Sales}}{\text{Total Sales}} + \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + \frac{\text{Minn. Tangible Prop.}}{\text{Total Tangible Prop.}} \div 3 = \%\ \text{to Minn.}$$

Using hypothetical percentages we secure a per cent to Minnesota thus:

	Within Minn.	Without Minn.	Total Percent
Sales	40%	60%	100%
Payroll	50%	50%	100%
Tangible Property	70%	30%	100%
Divide by Three	3/160%		
Percent to Minnesota	53⅓%		

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(2) **Under M.S.A. 290.19, Subd. 1 (1) (d).** In the alternative the following formula may be employed if a lesser percentage to Minnesota results by its use:

$$70\% \text{ of } \frac{\text{Minn. Sales}}{\text{Total Sales}} + 15\% \text{ of } \frac{\text{Minn. Payroll}}{\text{Total Payroll}} + 15\% \text{ of } \frac{\text{Minn. Tang. Prop.}}{\text{Total Tang. Prop.}} = \% \text{ to Minn.}$$

An illustration of the weighing of the factors in the alternative formula as provided in M.S.A. 290.19, Subd. 1 (1) (d) appears thus:

	Within Minn.	Weighted	Weighted Percentage
Sales	40%	70%	28.
Payroll	50%	15%	7.5
Tangible Property	70%	15%	10.5
Weighted averages percentage to Minnesota			46.0%

Since under the fact situation used in this illustration, the weighted average formula determines a lesser Minnesota percentage ratio, the lesser ratio may be used.

(c) **Apportionment of net income under M.S.A. 290.19, Subd. 1 (2).** If the business does not consist of the manufacture within or within and without Minnesota and the sale of personal property within and without the state, the taxable net income from such business shall be assigned to Minnesota on the basis of the percentage obtained by taking the arithmetic average of the three factors of (1) tangible property, (2) payroll and (3) sales, gross earnings or receipts, or on the basis of the percentage obtained by taking the weighted average of these three factors (15 per cent of the property percentage, 15 per cent of the payroll percentage and 70 per cent of the sales, gross earnings or receipts percentage), whichever is the lesser. The methods prescribed in this paragraph are presumed to properly reflect the taxable net income assignable to this State.

The single factor of sales, gross earnings or receipts may be used only if (1) the use of the arithmetic average of the three factors or the use of the weighted average of those factors, whichever is the lesser, will not properly reflect the taxable net income assignable to this State, and (2) the use of the single factor of sales, gross earnings or receipts will properly and fairly reflect such income.

The separate or segregated accounting method may be used only where the business carried on within this State is not an integral part of a business carried on both within and without this State. If this method is used, it is subject to the same limitations as those set forth in the preceding paragraph.

Those taxpayers who apportion a part of their income to Minnesota are required to complete Schedules T and U and attach them to their returns when filed.

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(d) **Definition of terms.—**

(1) **Manufacture.** Generally, the word "manufacture" is defined as the production of an article for use from raw or prepared materials by giving such materials new forms, qualities, or combinations, whether by hand labor or machine. Whether a taxpayer's business consists of manufacture of personal property is a question of fact to be determined in each individual case.

In order for a business to consist of the manufacture in Minnesota of personal property within the purview of M.S.A. 290.19, Subd. 1 (1), the operations of "manufacture" must occur within the geographical territory of this State.

(2) The property element of the apportionment formula considered above shall include land, buildings, machinery, and equipment, inventories and other tangible personal property actually used by the taxpayer during the taxable year in producing income subject to apportionment by formula. Tangible property from which income is derived which is to be separately allocated under M.S.A. 290.17 and 290.18 may not be considered as property includible in the apportionment factor. Cash on hand or in banks, shares of stock, notes, bonds, accounts receivable, or other evidences of indebtedness, special privileges, franchises, and good will, are specifically excluded from the property factor. The value of tangible property to be used in the apportionment fraction shall be the cost or other allowable income tax basis adjusted for allowable depreciation. The valuations of property both within and without Minnesota shall be the averages during the year and must be on a commensurate basis.

(3) The payroll element of the apportionment formula considered above shall be the payrolls paid or incurred by the taxpayer for the taxable year under review and wages or salaries paid or incurred in Minnesota shall be determined to be paid or incurred in Minnesota provided the individual with respect to whom such wages or salaries are paid is either employed within this State or is actually engaged in work in the territorial confines of this State or, if working without this State, is identified with or accountable to an office within this State.

The wages or salaries paid to officers and employees working from Minnesota offices are considered as Minnesota payroll even though their employment requires them to spend working time without this State. Officers and employees whose employment requires them to work without the state entirely and who are assigned to an office without Minnesota, are not considered Minnesota employees for the purpose of apportionment even though their salaries are paid from the taxpayer's general offices in Minnesota.

(4) Sales assignable to this State shall include sales made within Minnesota and sales made through, from or by of-

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fices, agencies, branches or stores located within Minnesota. All sales shall be deemed allocable to Minnesota unless it can be shown to the satisfaction of the Commissioner that such sales were negotiated or effected by agents of the taxpayer chiefly situated at, connected with, or sent out from premises for the transaction of business, owned or rented by the taxpayer or by his agents or agencies outside the state. Minnesota sales are not restricted to acts or activities that result immediately in a sales transaction, but include preliminary negotiations of a transaction which may later be completed either in Minnesota or outside of Minnesota, including interstate business.

(e) **Allocation of Federal Income Taxes paid.** See Reg. 2018 (1).

STET this rule.

2020 PETITION FOR APPLICATION OF OTHER THAN PRESCRIBED APPORTIONMENT METHOD.

The general rule is that the specific statutory methods prescribed in M.S.A. 290.19 shall be employed in the determination of net income allocable to this State. However, any taxpayer feeling aggrieved by the application, to his case, of the method so prescribed may petition the Commissioner of Taxation for determination of such taxable net income on some other basis, including separate accounting.

The petition so filed should state, (a) the name and address of the taxpayer, (b) in a case of a corporation, the state of incorporation and the principal office or place of business, (c) designation of the year involved, (d) a statement of the kind, or kinds, of business in which the taxpayer is engaged, from which the income was derived for the taxable year stated in the petition, (e) a detailed statement of the manner in which sales are effected within this State, (f) a computation of Minnesota taxable net income in accordance with the method of assignment of income petitioned for, (g) a summary statement of the facts upon which the taxpayer relies to sustain his view that the application of the methods prescribed by M.S.A. 290.19 will be unjust as applied to his case and that the method proposed will fairly reflect the taxable net income properly assignable to this State.

A petition within the meaning of M.S.A. 290.20 shall be deemed to have been filed by the taxpayer if the taxpayer in his return uses a method other than the methods prescribed by M.S.A. 290.19 and attaches to the return a statement setting forth the reasons for the use of such other method.

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2021 (2) CONTRIBUTIONS AND GIFTS.

(a) Subject to the percentage limitations in paragraph (e) of this regulation, a credit against taxable net income is allowed for contributions or gifts made during the taxable year:

(1) To or for the use of the State of Minnesota or any of its political subdivisions, if the contribution or gift was made exclusively for public purposes.

(2) To or for the use of any community chest, corporation, organization, trust, fund, association, or foundation, if

(A) it is located in and carrying on substantially all of its activities within this State, and

(B) it is organized and operating exclusively for religious, charitable, public cemetery, scientific, literary, artistic, or educational purposes, or for the prevention of cruelty to children or animals, and

(C) no part of the net earnings inures to the benefit of any private stockholder or individual.

(3) To a fraternal society, order, or association, operating under the lodge system, if

(A) it is located in and carrying on substantially all of its activities within this State, and

(B) such contributions or gifts are to be used exclusively for the purposes specified in clause (2) (B) above.

(4) To or for posts or organizations of war veterans or auxiliary units or societies of such posts or organizations, if

(A) they are within the State, and

(B) no part of their net income inures to the benefit of any private shareholder or individual.

(5) To a political party as defined in M.S.A. 200.08, or a political candidate as defined in M.S.A. 211.01, or a political cause when sponsored by any party or association or committee as defined in M.S.A. 211.01 in a maximum amount not to exceed the following:

(A) contributions made by individual natural persons	$ 100.00
(B) contributions made by a national committeeman, national committeewoman, state chairman or state chairwoman of a political party as defined in M.S.A. 200.08	$1,000.00

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tribution or gift to organizations described in M.S.A. 290.21 (2) payment of which contribution or gift is made after the close of the taxable year and on or before the 15th day of the third month following the close of such year if, during such year, the board of directors authorized such contribution or gift. The election may be made only at the time of filing the return for such taxable year and shall be signified by reporting such contribution or gift on the return. There shall be attached to such return a written declaration that the resolution authorizing the contribution or gift was adopted by the board of directors during the taxable year, and such declaration shall be verified by a statement signed by the president or other principal officer of the corporation that it is made under the penalties of perjury. In addition to the written declaration referred to in the preceding sentence, a copy of the resolution of the board of directors authorizing such contribution or gift shall be attached to the return.

(e) In the case of a corporation, the total credit against the taxable net income for contributions and gifts shall not exceed 15 per cent of a net amount which amount is computed by subtracting from the taxpayer's taxable net income the credits allowable under M.S.A. 290.21 other than those for contributions or gifts.

(f) If the contribution or gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the contribution or gift.

(g) Claims for credit under M.S.A. 290.21 (2) must be sustained, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing the name and address of the contributor or donor, the amount of the contribution or gift, and the date it was made, and by such other information as the Commissioner may deem necessary.

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(C) contributions made by a congressional district committeeman or committeewoman of a political party as defined in M.S.A. 200.08.....$ 350.00

(D) contributions made by a county chairman or chairwoman of a political party as defined in M.S.A. 200.08.$ 150.00

(b) Subject to the percentage limitations in paragraph (f) of this regulation, a credit against taxable net income is allowed in the ratio of the taxpayer's Minnesota taxable net income to his total net income for contributions or gifts made during the taxable year:

(1) To or for the use of the United States of America for exclusively public purposes.

(2) To or for the use of any community chest, corporation, trust, fund, association, or foundation, organized and operated exclusively for any of the purposes specified in paragraph (a) (2) (B) of this regulation, but which do not carry on substantially all of their activities within Minnesota.

(3) To or for the use of any fraternal society, order, or association, operating under the lodge system organized and operated exclusively for any of the purposes specified in paragraph (a) (2) (B) of this regulation, but which do not carry on substantially all of their activities within Minnesota.

(4) To or for the use of posts or organizations of war veterans or auxiliary units or societies of such posts or organizations if such posts, organizations, etc., do not carry on substantially all of their activities within Minnesota.

(c) For purposes of this regulation, the determination of whether or not any organization described in M.S.A. 290.21 (2) (b), (2) (c) or (2) (d) is "carrying on substantially all" of its activities within the State of Minnesota will be made by examining the activities carried on by the organization in the light of the purpose or purposes of such organization.

(d) A credit against taxable net income under M.S.A. 290.21 (2) is allowable to individuals and corporations only with respect to contributions or gifts which were actually paid during the taxable year. A credit is not allowable for contributions or gifts which were pledged or accrued during the taxable year but not actually paid during the taxable year. However, an exception is made for corporations reporting on the accrual basis (see following paragraph).

For taxable years beginning after December 31, 1954, a corporation reporting its taxable income on the accrual basis may elect to have considered as paid during the taxable year any con-

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2021 (3) DIVIDEND CREDIT FOR CORPORATIONS.

For all taxable years beginning after December 31, 1946, the following corporate taxpayers are entitled to a credit of 85% of dividends received from another corporation: when the corporate stock with respect to which dividends are paid does not constitute the stock in trade of the taxpayer or would not be included in the inventory of the taxpayer, or does not constitute property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or when the trade or business of the taxpayer does not consist principally of the holding of the stocks and the collection of the income and gains therefrom.

In those cases where a taxpayer is entitled to a credit of 85% of dividends received from another corporation, the following rules with respect to the remaining 15% of the dividends shall apply:

The term "dividend credit" as used hereafter in this regulation shall mean the credit applicable to the remaining 15% of the dividends only.

A dividend credit is allowable to a corporation only in the event that the recipient corporation owns 80 per cent or more of all the voting stock of the corporation paying the dividend. In such an event, the amount of the dividend that can be credited against taxable net income is the whole thereof, if the dividend was paid out of corporate income earned wholly from income producing business or activities carried on within this State.

The term "income" includes any income whether or not includible in computing "net income" and "taxable net income" under the Act. The term "business" means in this clause business in an economic sense.

If the income out of which the dividends are declared was derived from business done within and without this State, the amount of dividend credit allowable is determined by applying the ratio which the Minnesota taxable net income for the taxable year preceding that of the dividend distribution bears to the entire corporate net income for such year.

The terms "taxable net income" and "net income" as used in this paragraph, refer to those terms as defined by other provisions of the Act. It will be necessary, before applying this allocation formula, to establish that the dividends are from income derived from business activities carried on partly within and without this State—this burden being on the taxpayer.

Example 1. The A Corporation owns 60% of the voting stock of the B Corporation. No dividend credit is allowable to the A Corporation with respect to any dividends received from the B Corporation.

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Example 2. The T Corporation owns 81% of the voting stock of the L Corporation which operates wholly within Minnesota. The T Corporation is allowed 100% dividend credit with respect to dividends received from the L Corporation.

Example 3. The Y Corporation owns 80% of the voting stock of the Z Corporation which operates within and without the state. Assume that the percentage of the Z Corporation's Minnesota taxable net income to its total net income for the preceding taxable year was 40%. The Y Corporation is, in that event, allowed a dividend credit equal to 40% of the dividends received from the Z Corporation.

In all other cases no credit is permitted by law except as otherwise provided in this regulation.

Any taxpayer claiming the credit of 85% of the dividends received from another corporation and any portion of the remaining 15% of the dividends received must submit with its annual income tax return a detailed statement with full information in support of its position that it is entitled to the credit.

For the taxable years beginning after December 31, 1946, a corporation whose trade or business consists principally of the holding of stock and the collection of the income and gains therefrom is allowed a credit against net income for the amount of the dividends it receives from corporations if (1) it owns 80% or more of the voting stock of the corporation paying the dividend; and (2) the dividends were paid from income arising out of business done in this State. If the dividends are paid out of income arising from business done within and without the state the amount of the credit is determined in the ratio of taxable net income of the corporation paying the dividend assignable to Minnesota to the entire net income of the corporation. This ratio is determined by returns filed with the Income Tax Division for the taxable year preceding the distribution.

The term "income" includes income whether or not includible in computing "net income" and "taxable net income" under the Act. The term "business" means in this clause business in our economic sense.

The terms "taxable net income" and "net income" as used in this paragraph, refer to those terms as defined by other provisions of the Act. It will be necessary, before applying this allocation formula, to establish that the dividends are from income derived from business activities carried on partly within and partly without this State—this burden being on the taxpayer.

Any taxpayer claiming a credit for dividends received from another corporation must submit with its annual income tax return a detailed statement with full information in support of its position that it is entitled to the credit.

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If the corporation whose business consists principally of the holding of the stock and the collection of the income and gains therefrom does not own 80% or more of the voting stock of the corporation paying the dividend, no credit is allowed for the dividends received.

2021 (4) MUTUAL SAVINGS BANKS, REGULATED INVESTMENT COMPANIES AND BUILDING AND LOAN OR SAVINGS AND LOAN ASSOCIATIONS.

Mutual savings banks authorized and existing as such under the laws of this State, regulated investment companies as defined and limited by Section 851 of the Internal Revenue Code of 1954, and federal and state building and loan or savings and loan associations are not exempt from taxation under M.S.A. 290.05. However, they are allowed a credit against taxable net income under M.S.A. 290.21 (4) and (5). In the case of the mutual savings bank, a credit is allowed equal to the interest and dividends paid or credited during the taxable year to the bank's depositors. To each regulated investment company a credit is allowed equal to the interest and dividends paid during the taxable year. Building and loan or savings and loan associations are allowed a credit equal to the dividends paid during the taxable year to its members as members.

A dividend paid and declared by a regulated investment company in accordance with M.S.A. 290.21 (5) which the company desires to designate as a capital gain dividend, need not be designated as such within thirty days after the close of the year for which credit is claimed for purposes of the company's tax but will be properly designated as a capital gain dividend if it is designated as such both in the resolution of the company declaring the dividend, a copy of which is to be attached to the corporate return, and in a written notice mailed to shareholders at the time of payment of the dividend. Provided, however, that the distribution of the dividends must be made to shareholders in the twelve month period following the close of the taxable year.

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2023 (3)-1 UNUSED LOSS CARRYOVERS ON TERMINATION OF AN ESTATE OR TRUST.

(a) If, on the final termination of an estate or trust, a net operating loss carry-over under M.S.A. 290.095 or a capital loss carry-over under M.S.A. 290.16, Subd. 6 would be allowable to the estate or trust in a taxable year subsequent to the taxable year of termination but for the termination, the carry-over or carry-overs are allowed under M.S.A. 290.23, Subd. 3 (1) to the beneficiaries succeeding to the property of the estate or trust.

(b) The net operating loss carry-over and the capital loss carry-over are the same in the hands of a beneficiary as in the estate or trust and are taken into account in computing both

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taxable income and adjusted gross income. The first taxable year of the beneficiary to which the loss shall be carried over is the taxable year of the beneficiary in which or with which the estate or trust terminates. However, the last taxable year of the estate or trust (whether or not a short taxable year) and the first taxable year of the beneficiary to which a loss is carried over each constitute a taxable year for purposes of determining the number of years to which a loss may be carried over.

For example: A trust distributes all of its assets to A, the sole remainderman, and terminates on December 31, 1958, when it has a capital loss carry-over of $10,000 attributable to transactions during the taxable year 1957. A, who reports on the calendar year basis, otherwise has ordinary income of $10,000 and capital gains of $4,000 for the taxable year 1958. A would offset his capital gains of $4,000 against the capital loss of the trust and, in addition, deduct under M.S.A. 290.16, Subd. 5, $1,000 on his return for the taxable year 1958. The balance of the capital loss carry-over of $5,000 may be carried over to the years, 1959, 1960 and 1961 and 1962. For the treatment of the net operating loss carry-over when the last taxable year of the estate or trust is the last taxable year to which such loss can be carried over, see paragraph 4 hereof.

2023 (3)-2 EXCESS DEDUCTIONS ON TERMINATION OF AN ESTATE OR TRUST.

(a) If, on the termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under M.S.A. 290.23, Subd. 2(a) (relating to charitable contributions)) in excess of gross income, the excess is allowed under M.S.A. 290.23, Subd. 3(2) as a deduction to the beneficiaries succeeding to the property of the estate or trust. The deduction is allowed only in computing taxable income; it is not allowed in computing adjusted gross income. The deduction is allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates, whether the year of termination of the estate or trust is of normal duration or is a short taxable year.

For example: Assume that a trust distributes all of its assets to B and terminates on December 31, 1957. As of that date it had excess deductions, for example, because of corpus commissions on termination, of $18,000. B, who reported on the calendar year basis, could claim the $18,000 as a deduction for the taxable year 1957. However, if the deduction (when added to his other deductions) exceeds his gross income, the excess may not be carried over to the year 1958 or subsequent years.

(b) A deduction based upon a net operating loss carry-over will never be allowed to beneficiaries under both paragraphs (1) and (2) of M.S.A. 290.23, Subd. 3. Accordingly, a net operating

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loss deduction which is allowable to beneficiaries succeeding to the property of the estate or trust under the provisions of paragraph (1) of M.S.A. 290.23, Subd. 3 cannot also be considered a deduction for purposes of paragraph (2) of M.S.A. 290.23, Subd. 3 and paragraph (a) hereof. However, if the last taxable year of the estate or trust is the last year in which a deduction on account of a net operating loss may be taken, the deduction, to the extent not absorbed in that taxable year by the estate or trust, is considered an "excess deduction" under M.S.A. 290.23, Subd. 3 (2) and paragraph (a) hereof.

(c) Any item of income or deduction, or any part thereof, which is taken into account in determining the net operating loss or capital loss carry-over of the estate or trust for its last taxable year shall not be taken into account again in determining excess deductions on termination of the trust or estate within the meaning of M.S.A. 290.23, Subd. 3 (2) and paragraph (a).

2023 (3)-3 MEANING OF "BENEFICIARIES SUCCEEDING TO THE PROPERTY OF THE ESTATE OR TRUST."

(a) The phrase "beneficiaries succeeding to the property of the estate or trust" means those beneficiaries upon termination of the estate or trust who bear the burden of any loss for which a carry-over is allowed, or of any excess of deductions over gross income for which a deduction is allowed, under M.S.A. 290.23, Subd. 3.

(b) With reference to an intestate estate, the phrase means the heirs and next of kin to whom the estate is distributed, or if the estate is insolvent, to whom it would have been distributed if it had not been insolvent. If a decedent's spouse is entitled to a specified dollar amount of property before any distribution to other heirs and next of kin, and if the estate is less than that amount, the spouse is the beneficiary succeeding to the property of the estate or trust to the extent of the deficiency in amount.

(c) In the case of a testate estate, the phrase normally means the residuary beneficiaries (including a residuary trust), and not specific legatees or devisees, pecuniary legatees, or other nonresiduary beneficiaries. However, the phrase does not include the recipient of a specific sum of money even though it is payable out of the residue, except to the extent that it is not payable in full. On the other hand, the phrase includes a beneficiary (including a trust) who is not strictly a residuary beneficiary but whose devise or bequest is determined by the value of the decedent's estate as reduced by the loss or deductions in question. Thus the phrase includes:

(1) A beneficiary of a fraction of a decedent's net estate after payment of debts, expenses, etc.;

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(a) In computing gross income and deductions for the purposes of M.S.A. 290.095 a trust shall exclude that portion of the income and deductions attributable to the grantor or another person under M.S.A. 290.25, 290.27 and 290.28 (relating to grantors and others treated as substantial owners).

(b) An estate or trust shall not, for the purposes of M.S.A. 290.095 avail itself of the deductions allowed by M.S.A. 290.23, Subd. 2 (a) (relating to charitable contributions deductions) and M.S.A. 290.23, Subds. 6 and 8 (relating to deductions for distributions).

2026 (1) INCOME OF CERTAIN EMPLOYEES' TRUSTS, ANNUITY PLANS NOT TAXABLE.

The 1957 Act provides that a trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under M.S.A. 290.22 and that no other provisions of the Act shall apply with respect to such trust or its beneficiary if such trust or beneficiary comes within the provisions of Sections 401 and 402 of the Internal Revenue Code of 1954 as adapted to the provisions of this chapter under regulations issued by the Commissioner of Taxation.

The status of such a trust or its beneficiary under this Act shall be determined in accordance with Sections 401 and 402 of the Internal Revenue Code of 1954 as interpreted by applicable Federal Regulations.

Proof of Exemption and Returns: The fact that such trust is so exempt under said provisions of the Internal Revenue Code of 1954 as interpreted by applicable Regulations shall be evidenced to the Commissioner by the trustee filing with him:

(1) A copy of the determination letter issued by the United States Treasury Department as to its qualification under Section 401 (a) and exemption under the provisions of Section 501 (a) of the Internal Revenue Code;

(2) A verified copy of the trust instrument and of the employer's plan, showing all amendments.

(3) An executed copy of the annual return (Form 990-P) filed by the trustee with the United States Treasury Department for such trust in the form and within the time prescribed by Section 6033 of the Internal Revenue Code of the United States, as amended;

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(4) Items (1) and (2) need not be filed with respect to other than the first of such taxable years, except when necessary to show changes occurring since the last filing of which the trustee has written notice.

2026 (2) EMPLOYER CONTRIBUTIONS TO EMPLOYEES' TRUST OR ANNUITY PLANS AND COMPENSATION UNDER DEFERRED PAYMENT PLAN.

If contributions are paid by an employer to an employees' trust or annuity plan and compensation under a deferred payment plan, such contributions or compensation shall not be deductible under M.S.A. 290.09, but shall be deductible, if deductible under M.S.A. 290.09 without regard to this section, under this section but only to the extent provided in Section 404 of the Internal Revenue Code of 1954 as interpreted by applicable Federal Regulations.

If a deduction is claimed under this section, the employer must file with the Commissioner of Taxation copies of all of the information filed with the Bureau of Internal Revenue in connection with deductions claimed under Section 404 of the Internal Revenue Code of 1954.

2026 (3) TAXABILITY OF BENEFICIARY UNDER EMPLOYEES' TRUST OR ANNUITY PLAN.

Distributions received by a beneficiary from a trust or annuity plan of the kind described in Subdivisions 1 or 2 of M.S.A. 290.26 shall be treated in accordance with the provisions of M.S.A. 290.08, Subd. 4 and Sections 402 and 403 of the Internal Revenue Code of 1954 as interpreted by the Bureau of Internal Revenue.

2028.1 (1) COMMON TRUST FUND DEFINED.

For all taxable years beginning on or after January 1, 1945, a common trust fund is not subject to the taxes imposed by this chapter. A common trust fund means a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank whether acting alone or in conjunction with one or more co-fiduciaries, but solely in its capacity as trustee, administrator, executor or guardian. This

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MINNESOTA CODE OF AGENCY RULES

RULES OF THE DEPARTMENT OF REVENUE

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trust fund must be maintained in conformity with the rules and regulations prevailing from time to time of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by National Banks whether or not the bank maintaining such fund is a national bank or member of the Federal Reserve System.

2028.1 (2) COMPUTATION OF COMMON TRUST FUND INCOME.

The net income of the common trust fund is computed in the same manner and on the same basis as in the case of an individual except that: (1) Gains and losses from the sales or exchanges of capital assets must be segregated; (2) the ordinary net income, or the ordinary net loss, shall be computed after excluding gains and losses from sales and exchanges of capital assets; and (3) no credit provided in M.S.A. 290.21 for contributions shall be allowed in computing the net income of a common trust fund.

A common trust fund is not allowed a benefit of a capital loss carry-over provided by M.S.A. 290.16, Subd. 6, nor the net operating loss carry-over provided by M.S.A. 290.095, Subd. 2. Each participant in the common trust fund will receive the benefit of these deductions in the computation of his taxable net income.

2028.1 (3) INCOME OF PARTICIPANTS IN COMMON TRUST FUND.

Each participant in a common trust fund must include in computing its taxable net income for its taxable year within which the taxable year of the fund ends whether or not distributed and whether or not distributable: (1) its proportionate share of the ordinary net income, or its proportionate share of the ordinary net loss, of the common trust fund; (2) its proportionate share of the gains or losses from the sales or exchanges of capital assets held for not more than 6 months as part of its gains and losses from sales or exchanges of capital assets held for not more than 6 months as part of its gains and losses from sales or exchanges of capital assets held for not more than 6 months; (3) its proportionate share of the gains and losses from sales or exchanges of capital assets held for more than 6 months as part of its gains and losses from sales or exchanges of capital assets held for more than 6 months. The proportionate share of each participant in the gains and losses from sales or exchanges of capital assets, and the proportionate sum in the ordinary net income or the ordinary net loss shall be determined in accordance with the method of accounting adopted by the bank in accordance with the written plan under which the common trust fund is established and administered provided such

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method clearly reflects the income of each participant. The items of income and deductions are to be allocated to the periods between valuation dates within the taxable year established by such plan in which they were realized or sustained, and the ordinary net income or ordinary net loss and gains and losses from the sales or exchanges of capital assets computed for such period. The proportionate shares of the participants are then to be determined.

The provisions of M.S.A. 290.22, 290.23, 290.27 and 290.28 are applicable in determining the extent to which each participant's share of the income of the common trust fund is taxable to the participant, or to the beneficiaries, or to the grantor of the participant.

2028.1 (4) ADMISSION AND WITHDRAWAL OF PARTICIPANTS IN COMMON TRUST FUND.

The common trust fund realizes no gain or loss by the admission or withdrawal of a participant and the basis of the assets and the period for which they are deemed to have been held by the common trust for the purposes of M.S.A. 290.16, Subd. 4, are unaffected by such an admission or withdrawal. If a participant withdraws the whole or any part of its participating interest from the common trust fund, such withdrawal shall be treated as a sale or exchange by the participant of the participating interest or portion thereof which is withdrawn. A participant is not deemed to have withdrawn any part of his participating interest in the common trust fund so as to have completed a closed transaction by reason of the segregation and administration of an investment of the fund pursuant to the provisions of Subd. c (7) of Section 17 of Regulation F of the Board of Governors of the Federal Reserve System effective December 31, 1937. For the benefit of all of the participants in the common trust fund such segregated investment shall be considered as held by or on behalf of the common trust fund for the benefit ratably of all participants in the common trust fund at the time of segregation and any income or losses arising from its administration and liquidation shall constitute income or loss to the common trust fund apportionable among the participants for whose benefit the investment was segregated. The participants gain or loss upon withdrawal of its participating interest or portion thereof shall be measured by the difference between the amount received upon such withdrawal and the basis.

The basis of the participating interest or portion thereof withdrawn shall be the money contributed by the participant to the common trust fund to acquire the participating interest or portion thereof plus the income and gains less any ordinary losses and capital losses which were not distributed to the participant prior to withdrawal.

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2028.1 (5) TAX RETURNS OF COMMON TRUST FUNDS.

A return must be filed by every bank maintaining a common trust fund on Form I-2. This return shall show the names and addresses of the participants who would be entitled to share in the net income if distributed and the amount of the proportionate share of each participant. If the taxable year of a common trust fund is different from that of a participant, the income which the participant is required to include in its return shall be based upon net income of the common trust fund for its taxable year ending within the taxable year of the participant.

2028.1 (7) COMMON TRUST FUND NET OPERATING LOSS DEDUCTION.

The benefit of the deduction for net operating losses shall not be allowed to a common trust fund. This deduction is allowed to the participant of the common trust fund in the same manner as a deduction is allowed a member of a partnership. In the computation of such a deduction, the participant in the common trust fund shall take into account its pro rata share of the income and losses of the common trust fund in the same manner as a member of a partnership.

2029 LIABILITY OF TRANSFEREES AND FIDUCIARIES.

The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary in respect of any income tax imposed by the Act, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by the Act, except as hereinafter provided.

The term "transferee" as used in this regulation includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in M.S.A. 290.13, and all other classes of distributees.

The period of limitation for assessment and collection of the liability of a transferee or of a fiduciary, referred to in the first paragraph of this regulation, is as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the taxpayer. Action may be brought for the collection of such liability within one year after the expiration of the period of limitation for the commencement of the action against the taxpayer.

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(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer one year after the expiration of the period of limitation for assessment against the preceding transferee, or 3½ years after the expiration of the period of limitation for assessment against the taxpayer, whichever of the two periods (the 1-year period or the 3½-year period) first expires. In such case the liability may be collected by action brought within one year after the expiration of the period of limitation for the commencement of the action against that preceding transferee but only if within four years after the expiration of the period of limitation for bringing an action against the taxpayer.

(3) If a court proceeding against the taxpayer or last preceding transferee for the collection of the tax or liability in respect thereof, respectively, has been begun within the period of limitation for the bringing of such proceeding, then within one year after the return of execution in such proceeding; and the period of limitation for collection by action expires one year after the said liability is assessed.

(4) In the case of the liability of a fiduciary, not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later. The liability may be collected by action brought within one year after assessment.

(5) For the purpose of determining the period of limitation for assessment against a transferee or a fiduciary, if the taxpayer is deceased, or, in the case of a corporation, if it has terminated its existence, the period of limitation of assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

2030 DUTIES OF FIDUCIARIES.

As soon as the Commissioner receives notice that a person is acting in a fiduciary capacity, such fiduciary must, except as otherwise specifically provided, assume the powers, rights, duties, and privileges of the taxpayer with respect to income tax imposed by M.S.A. 290.03 (3) and (4). If the person is acting as a fiduciary for a transferee or other person subject to the liability specified in M.S.A. 290.29, such fiduciary is required to assume the powers, rights, duties, and privileges of the transferee or other person under that section. The amount of the tax or liability is ordinarily not collectible from the personal estate of the fiduciary but is collectible from the estate of the taxpayer or from the estate of the transferee or other person subject to the liability specified in M.S.A. 290.29. The "notice to the Commissioner" provided for in M.S.A. 290.30 shall be written notice signed by the fiduciary and filed with the Commissioner. The

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notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for tax, and, if so, the year or years involved, or a liability at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary in respect of the payment of any tax from the estate of the taxpayer. Any such written notice which has been filed with the Commissioner shall be considered as sufficient notice to the Commissioner within the meaning of M.S.A. 290.30. Unless there is already on file with the Commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such evidence must be filed with and made a part of the notice. If the fiduciary capacity exists by order of court, a certified copy of the order may be regarded as such satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary in order to be relieved of any further duty or liability as such, must file with the Commissioner written notice that the fiduciary capacity has terminated as to him, accompanied by satisfactory evidence of the termination of the fiduciary capacity. The notice of termination should state the name and address of the person, if any, who has been substituted as fiduciary.

If the notice of the fiduciary capacity described in the preceding paragraph is not filed with the Commissioner prior to the sending of notice of a deficiency by registered mail to the last known address of the taxpayer, or the last known address of the transferee or other person subject to liability (see M.S.A. 290.29), no notice of the deficiency will be sent to the fiduciary. In such a case the sending of the notice to the last known address of the taxpayer, transferee, or other person, as the case may be, will be sufficient compliance with the requirements of the Act, even though such taxpayer, transferee, or other person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. This constitutes formal assessment of the tax and recourse from such order is to take an appeal directly to the Minnesota Board of Tax Appeals in accordance with the provisions of M.S.A. 271.06. The term "fiduciary" is defined to mean a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

This regulation, relating to the provisions of M.S.A. 290.30 shall not be taken to abridge in any way the powers and duties of fiduciaries provided for in other sections of the Act.

2031 (1) PARTNERS, NOT PARTNERSHIP, SUBJECT TO TAX.

Partners are liable for income tax only in their separate capacities. Partnerships as such are not subject to the income tax imposed by Chapter 290 but are required to make returns of

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income under the provisions of M.S.A. 290.41 and the regulations thereunder. For definition of the terms "partner" and "partnership," see M.S.A. 290.01, Subd. 3, and the regulations thereunder.

2031 (2)-1 INCOME AND CREDITS OF PARTNER.

(a) **General rule.** Each partner is required to take into account separately in his return his distributive share, whether or not distributed, of each class or item of partnership income, gain, loss, deduction, or credit described in subparagraphs (1) through (7) of this paragraph. (For the taxable year in which a partner includes his distributive share of partnership taxable income, see M.S.A. 290.31, Subd. 6 and Reg. 2031 (6).) Such distributive share shall be determined as provided in M.S.A. 290.31, Subd. 4 and Reg. 2031 (4). Accordingly, in determining his income tax:

(1) Each partner shall take into account, as part of his gains and losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the combined net amount of such gains and losses of the partnership.

(2) Each partner shall take into account, as part of his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the combined net amount of such gains and losses of the partnership.

(3) Each partner shall take into account, as part of his gains and losses from sales or exchanges of property described in M.S.A. 290.16, Subd. 9 (relating to property used in the trade or business and involuntary conversions), his distributive share of the combined net amount of such gains and losses of the partnership. The partnership shall not combine such items with items set forth in subparagraph (1) or (2) of this paragraph.

(4) Each partner shall take into account, as part of the charitable contributions paid by him, his distributive share of each class of charitable contributions paid by the partnership within the partnership's taxable year. M.S.A. 290.21 (2) determines the extent to which such amount may be allowed as a credit to the partner.

(5) (i) Each partner shall take into account separately, as part of any class of income, gain, loss, deduction, or credit, his distributive share of the following items: recoveries of bad debts (M.S.A. 290.071, Subd. 5); recoveries of prior taxes; gains and losses from wagering transactions; soil and water conservation expenditures (M.S.A. 290.09, Subd. 21); medical, dental, etc., expenses (M.S.A. 290.09, Subd. 10); alimony, etc., payments (M.S.A. 290.09, Subd. 14); amounts representing taxes and interest paid to cooperative apartment corporations (M.S.A. 290.09, Subd. 17); income, gain, or loss to the partnership under M.S.A. 290.31, Subd. 21 (2); and any items of income, gain, loss deduction, or

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credit subject to a special allocation under the partnership agreement which differs from the allocation of partnership taxable income or loss generally.

(ii) Each partner must also take into account separately his distributive share of any partnership item which if separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

(iii) Each partner shall aggregate the amount of his separate deductions, credits, and exclusions and his distributive share of partnership deductions, credits, and exclusions separately stated in determining the amount allowable to him of any deduction, credit, or exclusion under Chapter 290 as to which a limitation is imposed.

(6) Each partner shall also take into account separately his distributive share of the taxable income or loss of the partnership, exclusive of items requiring separate computations under subparagraphs (1) through (5) of this paragraph. For limitation on allowance of a partner's distributive share of partnership losses, see M.S.A. 290.31, Subd. 4 (4) and Reg. 2031 (4) (d).

(b) **Character of items constituting distributive share.** The character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in M.S.A. 290.31, Subd. 2 (1) (a) through (f) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. For example, a partner's distributive share of gain from the sale of depreciable property used in the trade or business of the partnership shall be considered as gain from the sale of such depreciable property in the hands of the partner. Similarly, a partner's distributive share of partnership charitable contributions to churches, educational organizations, or hospitals (M.S.A. 290.21 (2)) retains such character in the hands of the partner.

(c) **Gross income of a partner.**

(1) Where it is necessary to determine the amount or character of the gross income of a partner, his gross income shall include the partner's distributive share of the partnership, that is, the amount of gross income of the partnership from which was derived the partner's distributive share of partnership taxable income or loss (including items described in M.S.A. 290.31, Subd. 2 (1) (a) through (f)). For example, a partner is required to include his distributive share of partnership gross income:

(i) In computing his gross income for the purpose of determining the necessity of filing a return (M.S.A. 290.37);

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(ii) In determining the application of the provision permitting the spreading of income for services rendered over a 36-month period (M.S.A. 290.071, Subd. 2); and

(iii) In determining a partner's "gross income from farming" (M.S.A. 290.09, Subd. 21).

(2) In determining the applicability of the 6½ year period of limitation on assessment and collection provided in M.S.A. 290.49, Subd. 3 (relating to omission of more than 25 percent of gross income), a partner's gross income includes his distributive share of partnership gross income. In this respect, the amount of partnership gross income from which was derived the partner's distributive share of any item of partnership income, gain, loss, deduction, or credit (as included or disclosed in the partner's return) is considered as an amount of gross income stated in the partner's return for the purposes of M.S.A. 290.49, Subd. 3. For example, A, who is entitled to one-fourth of the profits of the ABCD partnership, which has $10,000 gross income and $2,000 taxable income, reports only $300 as his distributive share of partnership profits. A should have shown $500 as his distributive share of profits, which amount was derived from $2,500 of partnership gross income. However, since A included only $300 on his return without explaining in the return the difference of $200, he is regarded as having stated in his return only $1,500 ($300/$500 of $2,500) as gross income from the partnership.

2031 (2)-2 NET OPERATING LOSS DEDUCTION OF PARTNER.

For the purpose of determining a net operating loss deduction under M.S.A. 290.095, a partner shall take into account his distributive share of items of income, gain, loss, deduction, or credit of the partnership. The character of any such item shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. See M.S.A. 290.31, Subd. 2 (2) and Reg. 2031 (2)-1 (b). To the extent necessary to determine the allowance under M.S.A. 290.095, Subd. 4 (a) of the nonbusiness deductions of a partner (arising from both partnership and nonpartnership sources), the partner shall separately take into account his distributive share of the deductions of the partnership which are not attributable to a trade or business and combine such amount with his nonbusiness deductions from nonpartnership sources. Such partner shall also separately take into account his distributive share of the gross income of the partnership not derived from a trade or business and combine such amount with his nonbusiness income from nonpartnership sources. See M.S.A. 290.095 and the regulations thereunder.

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2031 (3) PARTNERSHIP COMPUTATIONS.

(a) Income and deductions.—

(1) The taxable income of a partnership shall be computed in the same manner as the taxable income of an individual, except as otherwise provided in this regulation. A partnership is required to state separately in its return the items described in M.S.A. 290.31, Subd. 2 (1) (a) through (e) and, in addition, to attach to its return a statement setting forth separately those items described in M.S.A. 290.31, Subd. 2 (1) (f) which the partner is required to take into account separately in determining his income tax. See Reg. 2031 (2)-1 (a) (5). The partnership is further required to compute and to state separately in its return:

(i) As taxable income under M.S.A. 290.31, Subd. 2 (1) (g), the total of all other items of gross income (not separately stated) over the total of all other allowable deductions (not separately stated), or

(ii) As loss under M.S.A. 290.31, Subd. 2 (1) (g), the total of all other allowable deductions (not separately stated) over the total of all other items of gross income (not separately stated).

The taxable income or loss so computed shall be accounted for by the partners in accordance with their partnership agreement.

(2) The partnership is not allowed the following deductions:

(i) The standard deduction provided in M.S.A. 290.09, Subd. 15.

(ii) The net operating loss deduction provided in M.S.A. 290.095. See Reg. 2031 (2)-2.

(iii) The additional itemized deductions for individuals provided in M.S.A. 290.09, as follows: medical, dental, etc., expenses (M.S.A. 290.09, Subd. 10); alimony, etc., payments (M.S.A. 290.09, Subd. 14); and amounts representing taxes and interest paid to a cooperative apartment corporation (M.S.A. 290.09, Subd. 17). However, see Reg. 2031 (2)-1, paragraph (a) (5) (i).

(iv) The deduction for capital loss carryover provided by M.S.A. 290.16, Subd. 6.

(3) The partnership is not allowed the following credits:

(i) The credit for charitable contributions provided in M.S.A. 290.21 (2).

(ii) The personal credits provided in M.S.A. 290.06, Subd. 3.

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(4) The partnership must report capital gains and losses in full. It is not permitted to report such gains and losses according to the method set forth in M.S.A. 290.16, Subd. 5.

(b) **Elections of the partnership.** Any elections affecting the computation of income derived from a partnership shall be made by the partnership. For example, elections of methods of accounting, of computing depreciation, and of treating soil and water conservation exependitures shall be made by the partnership and not by the partners separately. All partnership elections are applicable to all partners equally, but any election made by a partnership shall not apply to any partner's nonpartnership interests.

2031 (4) PARTNER'S DISTRIBUTIVE SHARE.

(a) **Effect of partnership agreement.** A partner's distributive share of any item or class of items of income, gain, loss, deduction, or credit of the partnership shall be determined by the partnership agreement, unless otherwise provided by M.S.A. 290.31, Subd. 4 and paragraph (b) through (e) of this regulation. For definition of partnership agreement, see M.S.A. 290.31, Subd. 26 (2).

(b) **Distributive share determined by income or loss ratio.—**

(1) If the partnership agreement makes no specific provision for the manner of sharing one or more items or classes of items, a partner's distributive share of such items shall be determined in accordance with the provisions of the partnership agreement for the division of the general profits or losses (that is, the taxable net income or loss of the partnership as described in M.S.A. 290.31, Subd. 2 (1) (g)).

(2) If the principal purpose of any provisions in the partnership agreement determining a partner's distributive share of a particular item is to avoid or evade the Minnesota income tax, the provision shall be disregarded and the partners' distributive shares of that item shall be determined in accordance with the ratio in which the partners divide the general profits or losses of the partnership (as described in M.S.A. 290.31, Subd. 2 (1) (g)). In determining whether the principal purpose of any provision in the partnership agreement for a special allocation is the avoidance or evasion of Minnesota income tax, the provision must be considered in relation to all the surrounding facts and circumstances. Among the relevant circumstances are the following: Whether the partnership or a partner individually has a business purpose for the allocation; whether the allocation has "substantial economic effect," that is, whether the allocation may actually affect the dollar amount of the partners' shares of the total partnership income or loss independently of tax consequences; whether related items of income, gain, loss, deduction, or

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credit from the same source are subject to the same allocation; whether the allocation was made without recognition of normal business factors and only after the amount of the specially allocated item could reasonably be estimated; the duration of the allocation; and the overall tax consequences of the allocation. The application of the provisions of this subparagraph may be illustrated by the following examples:

Example (1). The provisions of a partnership agreement for a year in which the partnership incurs losses on the sale of depreciable property used in the trade or business are amended to allocate such losses to one partner who has no such gains individually. An equivalent amount of partnership loss or deduction of a different character is allocated to other partners who individually have gains from the sale of depreciable property used in the trade or business. Since the purpose and effect of this allocation is solely to reduce the taxes of certain partners without actually affecting their shares of partnership income, such allocation will not be recognized. Under M.S.A. 290.31, Subd. 4 (2) (b), those items will be allocated to all the partners in accordance with the provisions of the partnership agreement for sharing partnership income or loss generally.

Example (2). Rather than impair the credit standing of the AB partnership by a distribution, the partners agree to invest surplus partnership funds in an equal dollar amount of municipal bonds and corporate stock. The partners further agree that A is to receive all the interest income and gain or loss from tax-exempt bonds and B is to receive all the dividend income and gain or loss from corporate stock. Such allocation has substantial economic effect and will be recognized in the absence of other circumstances showing that the principal purpose was tax avoidance or evasion. On the other hand, under an agreement with respect to partnership CD, it is provided that C's distributive share of income shall be the first $10,000 of tax-exempt income, and D's distributive share of income shall be the first $10,000 of dividend income, the balances to be divided equally. Since the principal purpose of this provision is to allocate tax-exempt interest to C, who is in a higher income tax bracket than D, it will be disregarded. Each partner's distributive share of such interest and dividends will then be allocated in accordance with the provisions of the partnership agreement for sharing partnership income or loss generally.

Example (3). KL is a brokerage partnership with assets consisting of securities with a basis of $20,000 and a value of $50,000. M makes a $25,000 cash contribution to the partnership in order to become an equal partner. Subsequently, when the value of the securities has appreciated to $74,000, they are sold. Of the $54,000 taxable gain on the sale of the securities, $24,000 (appreciation in value occurring after M became a partner) is

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allocated in equal shares to K, L, and M, in accordance with the ratio for sharing profits and losses generally. The $30,000 balance is allocated to K and L in the profit and loss ratio existing before M became a partner. This latter allocation attributes to K and L the appreciation in value of the securities occurring before M became a partner, even though the cash proceeds are a partnership asset in which all three partners share equally. This allocation has substantial ecenomic effect and will be recognized in the absence of other circumstances showing that the principal purpose of the allocation was tax avoidance or evasion.

Example (4). G and H enter into a partnership agreement to develop and market an electronic device. H, an electronics engineer, contributes $2,500 cash and agrees to devote his full-time services to the partnership. G contributes $100,000 cash and agrees to obtain a loan for the partnership of any additional capital needed. The partnership agreement provides that the full amount of any research and experimental expenditures and any interest on partnership loans are to be charged to G. It also provides that G's distributive share is to be 90 per cent of the partnership income or loss computed without reduction by such research and experimental expenditures and such interest, until all loans have been repaid and G has received through his 90 per cent share of income an amount equal to the full amount of such research and experimental expenditures, of such interest, and his share of any partnership operating losses. During this time H's distributive share will be 10 per cent. Thereafter, G and H will share profits and losses equally. Since all of the research and experimental expenditures and interest specially allocated to G are in fact borne by G, the allocation will be recognized in the absence of other circumstances showing that its principal purpose was tax avoidance or evasion.

(c) Contributed property.—

(1) **In general.** Where property has actually been contributed by a partner to a partnership (so as to become partnership property as among the partners and not merely property subject to the claims of partnership creditors), M.S.A. 290.31, Subd. 4 (3) and this paragraph provide rules for determining a partner's distributive share of depreciation, depletion, or gain or loss with respect to such contributed property. These rules do not apply to property, only the use of which is permitted the partnership by the partner who owns it. M.S.A. 290.31, Subd. 4 (3) and this paragraph provide certain alternatives in determining the partners' distributive shares of such items in order to account for precontribution appreciation or diminution in value of the property contributed. When the partnership agreement is silent as to the treatment of such items with respect to contributed property (and if such property is not an undivided interest as described in M.S.A. 290.31, Subd. 4 (3) (c)), depreciation, depletion, or gain or loss with respect to such property shall be treated in the same

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manner as though such items arose with respect to property purchased by the partnership. The application of this provision may be illustrated by the following examples:

Example (1). A and B form an equal partnership. A contributes $1,000 cash and B contributes inventory with an adjusted basis to him of $800 and a fair market value of $1,000. Under M.S.A. 290.31, Subd. 11, the basis of the inventory to the partnership is also $800. During the year, the inventory is sold for $1,100. There is no provision in the partnership agreement for treatment of items with respect to contributed property. Under M.S.A. 290.31, Subd. 4 (3) (a), the $300 profit on the sale of the inventory is treated as if it were gain on property that had been purchased by the partnership and subsequently sold. Therefore, each partner's distributive share of such profit on the inventory is $150.

Example (2). C and D form an equal partnership. C contributes machinery worth $10,000 with an adjusted basis to him of $4,000. D contributes $10,000 cash. Under the provisions of M.S.A. 290.31, Subd. 10 the basis of C's partnership interest is $4,000 and the basis of D's interest is $10,000. There is no provision in the partnership agreement relating to contributed property. If the contributed property depreciates at an annual rate of 10 per cent, the partnership will have an annual depreciation deduction of $400, which will result in a reduction of $200 in each partner's distributive share of partnership income. Thus, at the end of the first year, the adjusted basis of the contributed property will be $3,600. If the partnership has no other taxable income or loss for that year, each partner will have a deduction of $200, representing his distributive share of partnership loss for the year. C's adjusted basis for his interest will be $3,800 ($4,000, the original basis of his interest, reduced by $200); D's adjusted basis will be $9,800 ($10,000, reduced by $200).

Example (3). Assume that the property in example (2) of this subparagraph is sold at the beginning of the second year of partnership operation for $9,000. The partnership gain will be $5,400 ($9,000, the amount realized, less the adjusted basis of $3,600). Each partner's share of the $5,400 gain will be $2,700. If the partnership has no other taxable income or loss for that year, each partner will have a gain from the partnership of $2,700, representing his distributive share of gain from the sale of property used in the partnership business. C's adjusted basis for his interest will then be $6,500 (the basis of $3,800, increased by the gain of $2,700). D's adjusted basis will be $12,500 (the basis of $9,800, increased by the gain of $2,700). If the partnership is then terminated, and its assets consisting of $19,000 in cash are distributed to the partners pro rata in liquidation of their entire interests, C will have a capital gain of $3,000 ($9,500,

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the amount received, less $6,500, the adjusted basis of his interest). D will have a capital loss of $3,000 (D's adjusted basis, $12,500, reduced by the amount received, $9,500).

(2) Effect of partnership agreement.—

(i) If the partners so provide in the partnership agreement, depreciation, depletion, or gain or loss with respect to contributed property may be allocated among the partners in a manner which takes into account all or any portion of the difference between the adjusted basis and the fair market value of contributed property at the time of contribution. The allocation may apply to all contributed property or to specific items. The appreciation or diminution in value represented by the difference between the adjusted basis and the fair market value of contributed property at the time of contribution may thus be attributed to the contributing partner upon a subsequent sale or exchange of the property by the partnership. Such appreciation or diminution also may be used in allocating the allowable depreciation or depletion with respect to such property among the contributing partner and the noncontributing partners. In any case, however, the total depreciation, depletion, or gain or loss allocated to the partners is limited to a "ceiling" which cannot exceed the amount of gain or loss realized by the partnership or the depreciation or depletion allowable to it. The application of this subdivision may be illustrated by the following examples:

Example (1). Assume that partners C and D, in examples (2) and (3) of subparagraph (1) of this paragraph, agree under M.S.A. 290.31, Subd. 4 (3) (b) to attribute to C, the contributor of the machinery, the potential gain of $6,000 represented by the difference between its adjusted basis of $4,000 and its fair market value of $10,000. With his contribution of $10,000 cash, D has, in effect, purchased an undivided one-half interest in the property for $5,000. Since the property depreciates at an annual rate of 10 per cent, D would have been entitled to a depreciation deduction of $500 per year. However, since under the "ceiling" approach the partnership is allowed only $400 per year (10 per cent of $4,000), no more than $400 may be allocated between the partners, i.e., the partnership cannot allocate $500 of depreciation to D and thereby treat C as if C had received an additional $100 of income. Therefore, the partners allocate the $400 deduction for depreciation entirely to D and none to C, the contributor. At the end of the first year, the adjusted basis of the contributed property will be $3,600. Since the $400 deduction is allocated entirely to D, if the partnership has no other taxable income or loss, C will have no income or loss, and D will have a deduction of $400. C's basis, for his interest will remain $4,000. D's adjusted basis for his interest will be $9,600 ($10,000, the original basis of his interest, reduced by the deduction of $400).

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Example (2). Assume that the partners in example (1) of this subdivision also agree under M.S.A. 290.31, Subd. 4 (3) (b) that, upon a sale of the contributed property, the portion of the proceeds attributable to the excess of the fair market value of the property at date of contribution (less accumulated depreciation on such value) over its basis at date of contribution (less accumulated depreciation on such basis) shall result in gain to the contributing partner only. If the property is sold at the beginning of the second year of partnership operation for $9,000, the partnership gain of $5,400 ($9,000, the amount realized, less the adjusted basis of $3,600) must be allocated to the partners under the terms of the agreement. The fair market value of the property as depreciated is $9,000 ($10,000, the value on contribution, less $1,000 the accumulated depreciation on such value). Under M.S.A. 290.31, Subd. 4 (3) (b) and the terms of the partnership agreement, the $5,400 difference between $9,000, the fair market value as depreciated, and $3,600, the adjusted basis of the property, represents the portion of the gain to be allocated to C. None of this gain is allocated to D. (If the property were sold for more than $9,000, the portion of the gain in excess of $5,400 would be allocated equally between the partners in accordance with their agreement for sharing gains. If the property were sold for less than $9,000, the entire gain would be allocated to C and nothing to D.) If the partnership and partners engaged in no other transactions that year, C will report a gain of $5,400, and D, no income or loss. C's adjusted basis for his interest will then be $9,400 ($4,000, his original basis, increased by the gain of $5,400). D's adjusted basis will be $9,600 ($10,000, his original basis, less $400 depreciation deduction in the first partnership year). If the partnership is then terminated, and its assets consisting of $19,000 in cash are distributed to the partners pro rata in liquidation of their interest, C will have a capital gain of $100 ($9,500, the amount received, less $9,400, the adjusted basis of his interest). D will have a capital loss of $100 (the excess of D's adjusted basis, $9,600, over the amount received, $9,500).

(ii) For the effect of an agreement under M.S.A. 290.31, Subd. 4 (3) (b) on undivided interests in property contributed to the partnership where the partners' interests in the capital and profits of the partnership do not correspond with such undivided interests, see subparagraph (3) (ii) of this paragraph.

(3) Undivided interests.—

(i) M.S.A. 290.31, Subd. 4 (3) (c) provides a special rule for the allocation of depreciation, depletion, or gain or loss with respect to undivided interests in property contributed by the partners to a partnership where the partnership agreement does not provide otherwise. This provision applies only to property contributed to a partnership by all of its partners and only where the relative undivided interests of the partners in the property prior to the contribution are in the same ratio as their

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interests in the capital and in the profits of the partnership (except for depreciation, depletion, or gain or loss with respect to the contributed undivided interests) after the contribution. Where these conditions are met, depreciation, depletion, or gain or loss with respect to the undivided interests in contributed property shall be determined in the same manner as though such undivided interests continued to be held by the partners outside the partnership. The rule stated in M.S.A. 290.31, Subd. 4 (3) (c) applies only to the case where persons actually contribute undivided interests to a partnership. The provisions of this subdivision may be illustrated by the following examples:

Example (1). A and B are tenants in common owning undivided one-half interests in improved real estate consisting of land on which a factory is situated. They each contribute their respective undivided interests in the real estate to a partnership in which the profits are to be divided equally and, because the partners have equal shares in the capital, the assets will be divided equally on dissolution. A's basis for his undivided one-half interest is $4,000, of which $1,000 is allocable to the land and $3,000 to the factory. B's basis for his undivided one-half interest is $10,000, of which $3,000 is allocable to the land and $7,000 to the factory. The partnership agreement contains no provisions as to the allocation of depreciation or gain or loss on disposition of the property by the partnership. The factory depreciates at a rate of 5 percent a year. The annual partnership allowance for depreciation of $500 (5 percent of $10,000) will be allocated between the partners by allowing A a deduction of $150 (5 percent of $3,000, his basis for his undivided interest in the factory), and by allowing B a deduction of $350 (5 percent of $7,000, his basis for his undivided interest in the factory). At the end of the first year of partnership operation, A's adjusted basis for his undivided interest in the factory is $2,850 ($3,000 less $150), and B's adjusted basis is $6,650 ($7,000 less $350).

Example (2). If, in example (1) of this subdivision, the partnership at the end of the first year's operation sells the factory and land for $12,000, each partner's share of the gain or loss would be determined as follows: Since the undivided interests in the factory and the land are to be treated as though held by the partners outside the partnership, A's share of the proceeds of the sale is $6,000. His adjusted basis in the contributed property is $3,850 ($1,000 for the land and $2,850 for the factory). Therefore, his gain from the sale is $2,150. Since B's share of the proceeds is also $6,000, and his adjusted basis in the contributed property is $9,650 ($3,000 for the land and $6,650 for the factory), his loss is $3,650.

Example (3). Assume the same facts as in examples (1) and (2) of this subdivision, except that A and B do not enter into a partnership agreement. Assume further that

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they are found to be a partnership for income tax purposes because of their joint business activity, but that the factory and the land are not actually contributed by them to the partnership. Although A and B have permitted the partnership to use such properties, they continue to own the factory and the land in their individual capacities (as tenants in common), and the same tax consequences result as in examples (1) and (2) of this subdivision.

(ii) The allocation illustrated in subdivision (1) of this paragraph will not be affected by the contribution, either at the time of the original contribution or subsequent thereto, of additional property not held as undivided interests if the partners' respective interests in the capital and in the profits of the partnership (except for depreciation, depletion, or gain or loss with respect to the contributed undivided interests) remain the same as their undivided interests in the property previously contributed to the partnership. If the partners' interests in the capital and profits of the partnership are changed from their undivided interests in the property previously contributed to the partnership, the method of allocation of depreciation, depletion, or gain or loss with respect to such property no longer applies. Such a change of the partners' interests in capital and profits may result from a modification of the agreement, or from a change in a partners' respective interest in capital either as a result of a further contribution or as a result of a distribution. (However, drawings made throughout the year against profits and loans will be disregarded.) Where such a change takes place, the partners may agree under M.S.A. 290.31, Subd. 4 (3) (b) that depreciation, depletion, or gain or loss with respect to the property formerly held as undivided interests shall continue to be allocated in the same manner as prior to the change. These provisions may be illustrated by the following examples:

Example (1). C and D are tenants in common, each owing an undivided one-half interest in certain unimproved land. Each contributes his respective undivided interest in the land to a partnership in which each has an equal interest in capital and profits. C's basis for his one-half interest is $4,000; D's basis is $10,000. The fair market value of the land is $20,000. Subsequently, C contributes $5,000 cash to his share of partnership capital. As a result of C's additional contribution, he now has a 60-percent interest in partnership capital and D, a 40-percent interest, although profits and losses still are to be shared equally. Since the interests of the partners in the capital and profits of the partnership no longer correspond to their undivided interests in the land the method of allocation prescribed by M.S.A. 290.31, Subd. 4 (3) (c) no longer applies. Therefore, if the land is sold for $12,000, the partnership will have a loss of $2,000 ($14,000 partnership basis minus $12,000). Since the partnership agreement contains no special allocation for gain or loss with respect

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to contributed property the $2,000 loss is allocated as if such property had been purchased by the partnership, i.e., $1,000 to each partner.

Example (2). Assume in example (1) of this subdivision that the partners agree that, because of C's additional contribution of $5,000 cash, he is to have a 60-per cent interest in partnership capital. Profits and losses still are to be shared equally, except that gain or loss with respect to the land is, under M.S.A. 290.31, Subd. 4 (3) (b), to continue to be allocated in the same manner as it has been allocated under M.S.A. 290.31, Subd. 4 (3) (c) prior to the additional contribution. The land is sold for $12,000. C's share of the proceeds is $6,000. His basis for the land is $4,000. Therefore, he has a $2,000 gain. D's loss is $4,000 ($10,000 basis less $6,000 proceeds).

(d) **Limitation on allowance of losses.—**

(1) A partner's distributive share of partnership loss will be allowed only to the extent of the adjusted basis (before reduction by current year's losses) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred. A partner's share of loss in excess of his adjusted basis at the end of the partnership taxable year will not be allowed for that year. However, any loss so disallowed shall be allowed as a deduction at the end of the first succeeding partnership taxable year and subsequent partnership taxable years, to the extent that the partner's adjusted basis for his partnership interest at the end of any such year exceeds zero (before reduction by such loss for such year).

(2) In computing the adjusted basis of a partner's interest for the purpose of ascertaining the extent to which a partner's distributive share of partnership loss shall be allowed as a deduction for the taxable year, the basis shall first be increased under M.S.A. 290.31, Subd. 5 (1) and decreased under M.S.A. 290.31, Subd. 5 (2), except for losses of the taxable year and losses previously disallowed. If the partner's distributive share of the aggregate of items of loss specified in M.S.A. 290.31, Subd. 2 (1) (a), (b), (c), (f) and (g) exceeds the basis of the partner's interest computed under the preceding sentence, the limitation on losses under M.S.A. 290.31, Subd. 4 (4) must be allocated to his distributive share of such loss. This allocation shall be determined by taking the proportion that each loss bears to the total of all such losses. For purposes of the preceding sentence, the total losses for the taxable year shall be the sum of his distributive share of losses for the current year and his losses disallowed and carried forward from prior years.

(3) For the treatment of certain liabilities of the partner or partnership, see M.S.A. 290.31, Subd. 22 and Reg. 2031 (22).

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(4) The provisions of this paragraph may be illustrated by the following examples:

Example (1). At the end of the partnership taxable year 1955, partnership AB has a loss of $20,000. Partner A's distributive share of this loss is $10,000. At the end of such year, A's adjusted basis for his interest in the partnership (not taking into account his distributive share of the loss) is $6,000. Under M.S.A. 290.31, Subd. 4 (4), A's distributive share of partnership loss is allowed to him (in his taxable year within or with which the partnership taxable year ends) only to the extent of his adjusted basis of $6,000. The $6,000 loss allowed for 1955 decreases the adjusted basis of A's interest to zero. Assume that, at the end of partnership taxable year 1956, A's share of partnership income has increased the adjusted basis of A's interest in the partnership to $3,000 (not taking into account the $4,000 loss disallowed in 1955). Of the $4,000 loss disallowed for the partnership taxable year 1955, $3,000 is allowed A for the partnership taxable year 1956, thus again decreasing the adjusted basis of his interest to zero. If, at the end of partnership taxable year 1957, A has an adjusted basis of his interest of at least $1,000 (not taking into account the disallowed loss of $1,000), he will be allowed the $1,000 loss previously disallowed.

Example (2). At the end of the partnership taxable year 1955, partnership CD has a loss of $20,000. Partner C's distributive share of this loss is $10,000. The adjusted basis of his interest in the partnership (not taking into account his distributive share of such loss) is $6,000. Therefore, $4,000 of the loss is disallowed. At the end of partnership taxable year 1956, the partnership has no taxable income or loss, but owes $8,000 to a bank for money borrowed. Since C's share of this liability is $4,000, the basis of his partnership interest is increased from zero to $4,000. (See M.S.A. 290.31, Subds. 22 and 10, and Regs. 2031 (22) and 2031 (10).) C is allowed the $4,000 loss, disallowed for the preceding year under M.S.A. 290.31, Subd. 4 (4), for his taxable year within or with which partnership taxable year 1956 ends.

Example (3). At the end of partnership taxable year 1955, partner C has the following distributive share of partnership items described in M.S.A. 290.31, Subd. 2 (1): long-term capital loss, $4,000; short-term capital loss, $2,000; income as described in M.S.A. 290.31, Subd. 2 (1) (g), $4,000. Partner C's adjusted basis for his partnership interest at the end of 1955, before adjustment for any of the above items is $1,000. As adjusted under M.S.A. 290.31, Subd. 5 (1) (a), C's basis is increased from $1,000 to $5,000 at the end of the year. C's total distributive share of partnership loss is $6,000. Since without regard to losses, C has a basis of only $5,000, C is allowed only $5,000/$6,000 of each loss, that is, $3,333 of his long-term capital loss,

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and $1,667 of his short-term capital loss. C must carry forward to succeeding taxable years $667 as a long-term capital loss and $333 as a short-term capital loss.

(e) **Family partnerships.—**

(1) **In general.—**

(i) **Introduction.** The production of income by a partnership is attributable to the capital or services, or both, contributed by the partners. The provisions of M.S.A. 290.31 are to be read in the light of their relationship to M.S.A. 290.01, Subd. 20, which requires, inter alia, that income be taxed to the person who earns it through his own labor and skill and the utilization of his own capital.

(ii) **Recognition of donee as partner.** With respect to partnerships in which capital is a material income-producing factor, M.S.A. 290.31, Subd. 4 (5) (a) provides that a person shall be recognized as a partner for income tax purposes if he owns a capital interest in such partnership, whether or not such interest is derived by purchase or gift from any other person. If a capital interest in a partnership in which capital is a material income-producing factor is created by gift, M.S.A. 290.31, Subd. 4 (5) (b) provides that the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such distributive share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such distributive share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. For rules of allocation in such cases, see sub-paragraph (3) of this paragraph.

(iii) **Requirement of complete transfer to donee.** A donee or purchaser of a capital interest in a partnership is not recognized as a partner under the principles of M.S.A. 290.31, Subd. 4 (5) (a) unless such interest is acquired in a bona fide transaction, not a mere sham for tax avoidance or evasion purposes, and the donee or purchaser is the real owner of such interest. To be recognized a transfer must vest dominion and control of the partnership interest in the transferee. The existence of such dominion and control in the donee is to be determined from all the facts and circumstances. A transfer is not recognized if the transferor retains such incidents of ownership that the transferee has not acquired full and complete ownership of the partnership interest. Transactions between members of a family will be closely scrutinized, and the circumstances, not only at the time of the purported transfer but also during the periods preceding and following it, will be taken into consideration in determining the bona fides or lack of bona fides of the purported gift or sale. A partnership may be recognized for income tax purposes as to some partners but not as to others.

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(iv) **Capital as a material income-producing factor.** For purposes of M.S.A. 290.31, Subd. 4 (5) (a), the determination as to whether capital is a material income-producing factor must be made by reference to all the facts of each case. Capital is a material income-producing factor if a substantial portion of the gross income of the business is attributable to the employment of capital in the business conducted by the partnership. In general, capital is not a material income-producing factor where the income of the business consists principally of fees, commissions, or other compensation for personal services performed by members or employees of the partnership. On the other hand, capital is ordinarily a material income-producing factor if the operation of the business requires substantial inventories or a substantial investment in plant, machinery, or other equipment.

(v) **Capital interest in a partnership.** For purposes of M.S.A. 290.31, Subd. 4 (5), a capital interest in a partnership means an interest in the assets of the partnership, which is distributable to the owner of the capital interest upon his withdrawal from the partnership or upon liquidation of the partnership. The mere right to participate in the earnings and profits of a partnership is not a capital interest in the partnership.

(2) **Basic tests as to ownership.—**

(i) **In general.** Whether an alleged partner who is a donee of a capital interest in a partnership is the real owner of such capital interest, and whether the donee has dominion and control over such interest, must be ascertained from all the facts and circumstances of the particular case. Isolated facts are not determinative; the reality of the donee's ownership is to be determined in the light of the transaction as a whole. The execution of legally sufficient and irrevocable deeds or other instruments of gift under State law is a factor to be taken into account but is not determinative of ownership by the donee for the purposes of M.S.A. 290.31, Subd. 4 (5). The reality of the transfer and of the donee's ownership of the property attributed to him are to be ascertained from the conduct of the parties with respect to the alleged gift and not by any mechanical or formal tests. Some of the more important factors to be considered in determining whether the donee has acquired ownership of the capital interest in a partnership are indicated in subdivisions (ii) to (x), inclusive, of this subparagraph.

(ii) **Retained controls.** The donor may have retained such controls of the interest which he has purported to transfer to the donee that the donor should be treated as remaining the substantial owner of the interest. Controls of particular significance include, for example, the following:

(a) Retention of control of the distribution of amounts of income or restrictions on the distributions of amounts of income (other than amounts retained in the partnership an-

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nually with the consent of the partners, including the donee partner, for the reasonable needs of the business). If there is a partnership agreement providing for a managing partner or partners, then amounts of income may be retained in the partnership without the acquiescence of all the partners if such amounts are retained for the reasonable needs of the business.

(b) Limitation of the right of the donee to liquidate or sell his interest in the partnership at his discretion without financial detriment.

(c) Retention of control of assets essential to the business (for example, through retention of assets leased to the alleged partnership).

(d) Retention of management powers inconsistent with normal relationships among partners. Retention by the donor of control of business management or of voting control, such as is common in ordinary business relationships, is not by itself to be considered as inconsistent with normal relationships among partners, provided the donee is free to liquidate his interest at his discretion without financial detriment. The donee shall not be considered free to liquidate his interest unless, considering all the facts, it is evident that the donee is independent of the donor and has such maturity and understanding of his rights as to be capable of deciding to exercise, and capable of exercising his right to withdraw his capital interest from the partnership.

The existence of some of the indicated controls, though amounting to less than substantial ownership retained by the donor, may be considered along with other facts and circumstances as tending to show the lack of reality of the partnership interest of the donee.

(iii) **Indirect controls.** Controls inconsistent with ownership by the donee may be exercised indirectly as well as directly, for example, through a separate business organization, estate, trust, individual, or other partnership. Where such indirect controls exist, the reality of the donee's interest will be determined as if such controls were exercisable directly.

(iv) **Participation in management.** Substantial participation by the donee in the control and management of the business (including participation in the major policy decisions affecting the business) is strong evidence of a donee partner's exercise of dominion and control over his interest. Such participation presupposes sufficient maturity and experience on the part of the donee to deal with the business problems of the partnership.

(v) **Income distribution.** The actual distribution to a donee partner of the entire amount or a major portion of his distributive share of the business income for the sole benefit

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and use of the donee is substantial evidence of the reality of the donee's interest, provided the donor has not retained controls inconsistent with real ownership by the donee. Amounts distributed are not considered to be used for the donee's sole benefit if, for example, they are deposited, loaned, or invested in such manner that the donor controls or can control the use or enjoyment of such funds.

(vi) **Conduct of partnership business.** In determining the reality of the donee's ownership of a capital interest in a partnership, consideration shall be given to whether the donee is actually treated as a partner in the operation of the business. Whether or not the donee has been held out publicly as a partner in the conduct of the business, in relations with customers, or with creditors or other sources of financing, is of primary significance. Other factors of significance in this connection include:

(a) Compliance with local partnership, fictitious names, and business registration statutes.

(b) Control of business bank accounts.

(c) Recognition of the donee's rights in distributions of partnership property and profits.

(d) Recognition of the donee's interest in insurance policies, leases, and other business contracts and in litigation affecting business.

(e) The existence of written agreements, records, or memoranda, contemporaneous with the taxable year or years concerned, establishing the nature of the partnership agreement and the rights and liabilities of the respective partners.

(f) Filing of partnership tax returns as required by law.

However, despite formal compliance with the above factors, other circumstances may indicate that the donor has retained substantial ownership of the interest purportedly transferred to the donee.

(vii) **Trustees as partners.** A trustee may be recognized as a partner for income tax purposes under the principles relating to family partnerships generally as applied to the particular facts of the trust partnership arrangement. A trustee who is unrelated to and independent of the grantor, and who participates as a partner and receives distribution of the income distributable to the trust, will ordinarily be recognized as the legal owner of the partnership interest which he holds in trust unless the grantor has retained controls inconsistent with such ownership. However, if the grantor is the trustee, or if the trustee is amenable to the will of the grantor, the provisions of the trust instrument (particularly as to whether the trustee is subject to the responsibilities of a fiduciary), the provisions of the partner-

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ship agreement, and the conduct of the parties must all be taken into account in determining whether the trustee in a fiduciary capacity has become the real owner of the partnership interest. Where the grantor (or person amenable to his will) is the trustee, the trust may be recognized as a partner only if the grantor (or such other person) in his participation in the affairs of the partnership actively represents and protects the interests of the beneficiaries in accordance with the obligations of a fiduciary and does not subordinate such interests to the interests of the grantor. Furthermore, if the grantor (or person amenable to his will) is the trustee, the following factors will be given particular consideration:

(a) Whether the trust is recognized as a partner in business dealings with customers and creditors, and

(b) Whether, if any amount of the partnership income is not properly retained for the reasonable needs of the business, the trust's share of such amount is distributed to the trust annually and paid to the beneficiaries or reinvested with regard solely to the interests of the beneficiaries.

(viii) **Interests (not held in trust) of minor children.** Except where a minor child is shown to be competent to manage his own property and participate in the partnership activities in accordance with his interest in the property, a minor child generally will not be recognized as a member of a partnership unless control of the property is exercised by another person as fiduciary for the sole benefit of the child, and unless there is such judicial supervision of the conduct of the fiduciary as is required by law. The use of the child's property or income for support for which a parent is legally responsible will be considered a use for the parent's benefit. "Judicial supervision of the conduct of the fiduciary" includes filing of such accountings and reports as are required by law of the fiduciary who participates in the affairs of the partnership on behalf of the minor. A minor child will be considered as competent to manage his own property if he actually has sufficient maturity and experience to be treated by disinterested persons as competent to enter business dealings and otherwise to conduct his affairs on a basis of equality with adult persons, notwithstanding legal disabilities of the minor under State law.

(ix) **Donees as limited partners.** The recognition of a donee's interest in a limited partnership will depend, as in the case of other donated interests, on whether the transfer of property is real and on whether the donee has acquired dominion and control over the interest purportedly transferred to him. To be recognized for Minnesota income tax purposes, a limited partnership must be organized and conducted in accordance with the requirements of the applicable State limited-partnership law. The absence of services and participation in management by a donee

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in a limited partnership is immaterial if the limited-partnership meets all the other requirements prescribed in this paragraph. If the limited partner's right to transfer or liquidate his interest is subject to substantial restrictions (for example where the interest of the limited partner is not assignable in a real sense or where such interest may be required to be left in the business for a long term of years), or if the general partner retains any other control which substantially limits any of the rights which would ordinarily be exercisable by unrelated limited partners in normal business relationships, such restrictions on the right to transfer or liquidate, or retention of other control, will be considered strong evidence as to the lack of reality of ownership by the donee.

(x) **Motive.** If the reality of the transfer of interest is satisfactorily established, the motives for the transaction are generally immaterial. However, the presence or absence of a tax-avoidance motive is one of many factors to be considered in determining the reality of the ownership of a capital interest acquired by gift.

(3) **Allocation of family partnership income—**

(i) **In general.—**

(a) Where a capital interest in a partnership in which capital is a material income-producing factor is created by gift, the donee's distributive share shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor and except to the extent that the portion of such distributive share attributable to donated capital is proportionately greater than the distributive share attributable to the donor's capital: For the purpose of M.S.A. 290.31, Subd. 4, a capital interest in a partnership purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual, for the purpose of the preceding sentence, shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons.

(b) To the extent that the partnership agreement does not allocate the partnership income in accordance with subdivision (a) of this subdivision, the distributive shares of the partnership income of the donor and donee shall be reallocated by making a reasonable allowance for the services of the donor and by attributing the balance of such income (other than a reasonable allowance for the services, if any, rendered by the donee) to the partnership capital of the donor and donee. The portion of income, if any, thus attributable to partnership capital

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for the taxable year shall be allocated between the donor and donee in accordance with their respective interests in partnership capital.

(c) In determining a reasonable allowance for services rendered by the partners, consideration shall be given to all the facts and circumstances of the business, including the fact that some of the partners may have greater managerial responsibility than others. There shall also be considered the amount that would ordinarily be paid in order to obtain comparable services from a person not having an interest in the partnership.

(d) The distributive share of partnership income, as determined under subdivision (b) of this subdivision, of a partner who rendered services to the partnership before entering the Armed Forces of the United States shall not be diminished because of absence due to military service. Such distributive share shall be adjusted to reflect increases or decreases in the capital interest of the absent partner. However, the partners may by agreement allocate a smaller share to the absent partner due to his absence.

(ii) Special rules.—

(a) The provisions of subdivision (i) of this subparagraph, relating to allocation of family partnership income, are applicable where the interest in the partnership is created by gift, indirectly or directly. Where the partnership interest is created indirectly, the term "donor" may include persons other than the nominal transferor. This rule may be illustrated by the following examples:

Example (1). A father gives property to his son who shortly thereafter conveys the property to a partnership consisting of the father and the son. The partnership interest of the son may be considered created by gift and the father may be considered the donor of the son's partnership interest.

Example (2). A father, the owner of a business conducted as a sole proprietorship, transfers the business to a partnership consisting of his wife and himself. The wife subsequently conveys her interest to their son. In such case, the father, as well as the mother may be considered the donor of the son's partnership interest.

Example (3). A father makes a gift to his son of stock in the family corporation. The corporation is subsequently liquidated. The son later contributes the property received in the liquidation of the corporation to a partnership consisting of his father and himself. In such case for purposes of M.S.A. 290.31, Subd. 4, the son's partnership interest may be considered created by gift and the father may be considered the donor of his son's partnership interest.

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(b) The allocation rules set forth in M.S.A. 290.31, Subd. 4 (5) and subdivision (i) of this subparagraph apply in any case in which the transfer or creation of the partnership interest has any of the substantial characteristics of a gift. Thus allocation may be required where transfer of a partnership interest is made between members of a family (including collaterals) under a purported purchase agreement, if the characteristics of a gift are ascertained from the terms of the purchase agreement, the terms of any loan or credit arrangements made to finance the purchase, or from other relevant data.

(c) In the case of a limited partnership, for the purpose of the allocation provisions of subdivision (i) of this subparagraph, consideration shall be given to the fact that a general partner, unlike a limited partner, risks his credit in the partnership business.

(4) **Purchased interest.—**

(i) **In general.** If a purported purchase of a capital interest in a partnership does not meet the requirements of subdivision (ii) of this subparagraph, the ownership by the transferee of such capital interest will be recognized only if it qualifies under the requirements applicable to a transfer of a partnership interest by gifts. In a case not qualifying under subdivision (ii) of this subparagraph, if payment of any part of the purchase price is made out of partnership earnings, the transaction may be regarded in the same light as a purported gift subject to deferred enjoyment of income. Such a transaction may be lacking in reality either as a gift or as a bona fide purchase.

(ii) **Tests as to reality of purchased interests.** A purchase of a capital interest in a partnership, either directly or by means of a loan or credit extended by a member of the family, will be recognized as bona fide if:

(a) It can be shown that the purchase has the usual characteristics of an arm's-length transaction, considering all relevant factors, including the terms of the purchase agreement(as to price, due date of payment, rate of interest, and security, if any) and the terms of any loan or credit arrangement collateral to the purchase agreement; the credit standing of the purchaser (apart from relationship to the seller) and the capacity of the purchaser to incur a legally binding obligation; or

(b) It can be shown, in the absence of characteristics of an arm's-length transaction, that the purchase was genuinely intended to promote the success of the business by securing participation of the purchaser in the business or by adding his credit to that of the other participants. However, if the alleged purchase price or loan has not been paid or the obligation otherwise discharged; the factors indicated in subdivisions

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(a) and (b) of this subdivision shall be taken into account only as an aid in determining whether a bona fide purchase or loan obligation existed.

2031 (5) DETERMINATION OF BASIS OF PARTNER'S INTEREST.

(a) General rule.—

(1) M.S.A. 290.31, Subd. 5 and this regulation provide rules for determining the adjusted basis of a partner's interest in a partnership. A partner is required to determine the adjusted basis of his interest in a partnership only when necessary for the determination of his tax liability or that of any other person. The determination of the adjusted basis of a partnership interest is ordinarily made as of the end of a partnership taxable year. Thus, for example, such year-end determination is necessary in ascertaining the extent to which a partner's distributive share of partnership losses may be allowed. See M.S.A. 290.31, Subd. 4 (4). However, where there has been a sale or exchange of all or a part of a partnership interest or a liquidation of a partner's entire interest in a partnership, the adjusted basis of the partner's interest should be determined as of the date of sale or exchange or liquidation. The adjusted basis of a partner's interest in a partnership is determined without regard to any amount shown in the partnership books as the partner's "capital," "equity," or similar account. For example, A contributes property with an adjusted basis to him of $400 (and a value of $1,000) to a partnership. B contributes $1,000 cash. While under their agreement each may have a "capital account" in the partnership of $1,000, the adjusted basis of A's interest is only $400 and B's interest, $1,000.

(2) The original basis of a partner's interest in a partnership shall be determined under M.S.A. 290.31, Subd. 10 (relating to contributions to a partnership) or M.S.A. 290.31, Subd. 19 (relating to transfers of partnership interests). Such basis shall be increased under M.S.A. 290.31, Subd. 10 by any further contributions to the partnership and by the sum of the partner's distributive share for the taxable year and prior taxable years of—

(i) Taxable income of the partnership as determined under M.S.A. 290.31, Subd. 3,

(ii) Tax-exempt receipts of the partnership, and

(iii) The excess of the deductions for depletion over the basis of the depletable property.

(3) The basis shall be decreased (but not below zero) by distributions from the partnership as provided in M.S.A. 290.31, Subd. 14 and by the sum of the partner's distributive share for the taxable year and prior taxable years of—

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(i) Partnership losses (including capital losses), and

(ii) Partnership expenditures which are not deductible in computing partnership taxable income or loss and which are not capital expenditures.

(4) For the effect of liabilities in determining the amount of contributions made by a partner to a partnership or the amount of distributions made by a partnership to a partner, see M.S.A. 290.31, Subd. 22 and Reg. 2031 (22), relating to the treatment of certain liabilities. In determining the basis of a partnership interest on the effective date of M.S.A. 290.31 or any of the sections thereof, the partner's share of partnership liabilities on that date shall be included.

(b) **Alternative rule.** In certain cases, the adjusted basis of a partner's interest in a partnership may be determined by reference to the partner's share of the adjusted basis of partnership property which would be distributable upon termination of the partnership. The alternative rule may be used to determine the adjusted basis of a partner's interest where circumstances are such that the partner cannot practicably apply the general rule set forth in M.S.A. 290.31, Subd. 5 and paragraph (a) of this regulation, or where, from a consideration of all the facts, it is, in the opinion of the Commissioner, reasonable to conclude that the result produced will not vary substantially from the result obtainable under the general rule. Where the alternative rule is used, adjustments may be necessary in determining the adjusted basis of a partner's interest in a partnership. Adjustments would be required, for example, in order to reflect in a partner's share of the adjusted basis of partnership property any significant discrepancies arising as a result of contributed property, transfers of partnership interest, or distributions of property to the partners. The operation of the alternative rules may be illustrated by the following examples:

Example (1). The ABC partnership, in which A, B, and C are equal partners, owns various properties with a total adjusted basis of $1,500 and has earned and retained an additional $1,500. The total adjusted basis of partnership property is thus $3,000. Each partner's share in the adjusted basis of partnership property is one-third of this amount, or $1,000. Under the alternative rule, this amount represents each partner's adjusted basis for his partnership interest.

Example (2). Assume that partner A in example (1) of this paragraph sells his partnership interest to D for $1,250 at a time when the partnership property with an adjusted basis of $1,500 had appreciated in value to $3,000, and when the partnership also had $750 in cash. The total adjusted basis of all partnership property is $2,250 and the value of such property is $3,750. D's

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basis for his partnership interest is his cost, $1,250. However, his one-third share of the adjusted basis of partnership property is only $750. Therefore, for the purposes of the alternative rule, D has an adjustment of $500 in determining the basis of his interest. This amount represents the difference between the cost of his partnership interest and his share of partnership basis at the time of his purchase. If the partnership subsequently earns and retains an additional $1,500, its property will have an adjusted basis of $3,750. D's adjusted basis for his interest under the alternative rule is $1,750, determined by adding $500, his basis adjustment, to $1,250 (his one-third share of the $3,750 adjusted basis of partnership property). If the partnership distributes $250 to each partner in a current distribution, D's adjusted basis for his interest will be $1,500 ($1,000, his one-third share of the remaining basis of partnership property, $3,000, plus his basis adjustment of $500.

Example (3). Assume the BCD partnership in example (2) of this paragraph continues to operate. In 1960, D proposes to sell his partnership interest and wishes to evaluate the tax consequences of such sale. It is necessary, therefore, to determine the adjusted basis of his interest in the partnership. Assume further that D cannot determine the adjusted basis of his interest under the general rule. The balance sheet of the BCD partnership is as follows:

Assets	Adjusted Basis Per Books	Market Values
Cash	$ 3,000	$ 3,000
Receivables	4,000	4,000
Depreciable property	5,000	5,000
Land held for investment	18,000	30,000
Total	$30,000	$42,000

Liabilities and Capital	Per Books
Liabilities	$ 6,000
Capital Accounts: B	4,500
C	4,500
D	15,000
Total	$30,000

The $15,000 representing the amount of D's capital account does not reflect the $500 basis adjustment arising from D's purchase of his interest. See example (2) of this paragraph. The adjusted basis of D's partnership interest determined under the alternative rule is as follows:

D's share of the adjusted basis of partnership property (reduced by the amount of liabilities) at time of proposed sale	$15,000

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D's share of partnership liabilities under the partnership agreement liabilities are shared equally)	2,000
D's basis adjustment from example (2).	500
Adjusted basis of D's interest at the time of proposed sale, as determined under alternative rule	$17,500

2031 (6) TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

(a) Year in which partnership income is includible.—

(1) In computing his taxable income for the taxable year, a partner is required to include his distributive share of partnership items set forth in M.S.A. 290.31, Subd. 2 for any partnership year ending within or with his taxable year. A partner shall also include in his taxable income for a taxable year "guaranteed payments" under M.S.A. 290.31, Subd. 7 (4) which are made to him in a partnership taxable year ending within or with his taxable year. The provisions of this subparagraph may be illustrated by the following example:

Example. Partner A reports his income for a calendar year, while the partnership of which he is a member reports its income for a fiscal year ending May 31. During the partnership taxable year ending May 31, 1956, A received guaranteed payments of $1,200 for services and for the use of capital. Of this amount, $700 was received by A between June 1 and December 31, 1955, and the remaining $500 was received by him between January 1 and May 31, 1956. This entire $1,200 received by A is includible in his taxable income for the calendar year 1956 (together with his distributive share of partnership items set forth in M.S.A. 290.31, Subd. 2 for the partnership taxable year ending May 31, 1956).

(2) If a partner receives distributions under M.S.A. 290.31, Subd. 12 or sells or exchanges all or part of his partnership interest, any gain or loss arising therefrom does not constitute partnership income and is includible in the partner's gross income for his taxable year in which the payment is made. See M.S.A. 290.07, Subds. 6 and 7.

(b) Adoption or change in taxable year.—

(1) Partnership taxable year.—

(i) The taxable year of a partnership shall be determined as though the partnership were a taxpayer.

(ii) A newly formed partnership may adopt a taxable year which is the same as the taxable year of all its principal partners (or the same as the taxable year to which all of its

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principal partners are concurrently changing) without securing prior approval from the Commissioner, or it may adopt a calendar year without securing prior approval from the Commissioner if all its principal partners are not on the same taxable year. In any other case, a newly formed partnership must secure prior approval from the Commissioner for the adoption of a taxable year.

(iii) An existing partnership may not change its taxable year without securing prior approval from the Commissioner, unless all its principal partners have the same taxable year to which the partnership changes, or unless all its principal partners concurrently change to such taxable year.

(2) **Partner's taxable year.** A partner may not change his taxable year without securing prior approval from the Commissioner. See M.S.A. 290.07, Subd. 1 and the regulations thereunder.

(3) **Principal partner.** For the purpose of this paragraph, a principal partner is a partner having an interest of 5 percent or more in partnership profits or capital.

(4) **Application for approval.—**

(i) **Change.** Application for a change in a taxable year shall be filed on Form 124 with the Commissioner on or before the last day of the month following the close of the short period for which a return is required to effect the change of taxable year.

(ii) **Adoption.** Where a newly formed partnership is required to secure prior approval from the Commissioner for the adoption of a taxable year, the partnership shall file an application on Form 124 with the Commissioner on or before the last day of the month following the close of the taxable year to be adopted. The partnership shall modify Form 124 to the extent necessary to indicate that it is an application for adoption of a taxable year.

(iii) **Business purpose.** Where prior approval is required under this paragraph, the applicant must establish a business purpose to the satisfaction of the Commissioner. For example, partnership AB, which is on a calendar year, is engaged in a business which has a natural business year (the annual accounting period encompassing all related income and expenses) ending on September 30th. The intention of the partnership to make its tax year coincide with such natural business year constitutes a sufficient business purpose.

(5) **Returns.—**

(i) **Partner.** A partner who changes his taxable year shall make his return for a short period in accordance with

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M.S.A. 290.07, Subd. 1, and shall attach to the return a copy of the letter from the Commissioner granting approval for the change of taxable year.

(ii) **Partnership.—**

(a) A partnership which changes its taxable year shall make its return for a short period in accordance with M.S.A. 290.07, Subd. 1, but shall not annualize the partnership taxable income. The partnership shall attach to the return either a copy of the letter from the Commissioner granting approval of the change of taxable year, or a statement indicating that the partnership is changing its taxable year to the same taxable year as that of all its principal partners or to the same taxable year as that to which all its principal partners are concurrently changing.

(b) Any newly formed partnership shall file with its first return either:

(1) A copy of the letter from the Commissioner approving the adoption of a partnership taxable year which is not the same as the taxable year of all its principal partners; or

(2) A statement indicating that the taxable year it has adopted is the same as the taxable year of all its principal partners, or that all its principal partners are concurrently changing to the taxable year it has adopted; or

(3) A statement that all its principal partners are not on the same taxable year and that it is adopting a calendar year without prior approval.

(6) **Effective date.** M.S.A. 290.31, Subd. 6 (2) applies to any partnership which adopts or changes to a taxable year beginning after December 31, 1954, and to any partner who changes to a taxable year beginning after that date. If a partnership has changed to or adopted, or if a partner has changed to, a taxable year beginning after December 31, 1954, without obtaining prior approval of the Commissioner, and if, under the provisions of this paragraph, prior approval is required for the change or adoption, such annual accounting period will not be accepted as a taxable year until approval thereof is secured. Under these circumstances, an application to change to or adopt the desired taxable year will be considered timely if filed within 90 days following the promulgation of the regulations under M.S.A. 290.31, Subd. 6.

(c) **Closing of partnership year.—**

(1) **General rule.** M.S.A. 290.31, Subd. 6 (5), (6) and (7) and this paragraph provide rules governing the closing of partnership years. The closing of a partnership taxable year or

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a termination of a partnership for State income tax purposes is not necessarily governed by the "dissolution," "liquidation," etc., of a partnership under State or local law. The taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's entire interest in the partnership (as defined in M.S.A. 290.31, Subd. 26 (3)), or the sale or exchange of a partner's interest in the partnership, except in the case of a termination of a partnership and except as provided in subparagraph (2) of this paragraph. In the case of termination, the partnership taxable year closes for all partners as of the date of termination. See M.S.A. 290.31, Subd. 8 (2), (3) and (4) and Reg. 2031 (8) (b).

(2) **Partner who retires or sells interest in partnership.—**

(i) **Disposition of entire interest.** A partnership taxable year shall close with respect to a partner who sells or exchanges his entire interest in a partnership, and with respect to a partner whose entire interest is liquidated. However, a partnership taxable year with respect to a partner who dies shall not close prior to the end of such partnership taxable year, or the time when such partner's interest (held by his estate or other successor) is liquidated or sold or exchanged, whichever is earlier. See subparagraph (3) of this paragraph.

(ii) **Inclusions in taxable income.** In the case of a sale, exchange, or liquidation of a partner's entire interest in a partnership, the partner shall include in his taxable income for his taxable year within or with which his membership in the partnership ends, his distributive share of items described in M.S.A. 290.31, Subd. 2 (1), and any guaranteed payments under M.S.A. 290.31, Subd. 7 (4), for his partnership taxable year ending with the date of such sale, exchange, or liquidation. In order to avoid an interim closing of the partnership books, such partner's distributive share of items described in M.S.A. 290.31, Subd. 2 (1) may, by agreement among the partners, be estimated by taking his pro rata part of the amount of such items he would have included in his taxable income had he remained a partner until the end of the partnership taxable year. The proration may be based on the portion of the taxable year that has elapsed prior to the sale, exchange, or liquidation, or may be determined under any other method that is reasonable. Any partner who is the transferee of such partner's interest shall include in his taxable income, as his distributive share of items described in M.S.A. 290.31, Subd. 2 (1) with respect to the acquired interest, the pro rata part (determined by the method used by the transferor partner) of the amount of such items he would have included had he been a partner from the beginning of the taxable year of the partnership. The application of this subdivision may be illustrated by the following example:

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Example. Assume that a partner selling his partnership interest on June 30, 1955, has an adjusted basis for his interest of $5,000 on that date; that his pro rata share of partnership income up to June 30 is $15,000; and that he sells his interest for $20,000. Under the provisions of M.S.A. 290.31, Subd. 6 (6) and (7), the partnership year with respect to him closes at the time of the sale. The $15,000 is includible in his income as his distributive share and, under M.S.A. 290.31, Subd. 5, it increases the basis of his partnership interest to $20,000, which is also the selling price of his interest. Therefore, no gain is realized on the sale of his partnership interest. The purchaser of this partnership interest shall include in his income as his distributive share his pro rata part of partnership income for the remainder of the partnership taxable year.

(3) Partner who dies.—

(i) When a partner dies, the partnership taxable year shall not close with respect to such partner prior to the end of the partnership taxable year. The partnership taxable year shall continue both for the remaining partners and the decedent partner. Where the death of a partner results in the termination of the partnership, the partnership taxable year shall close for all partners on the date of such termination under M.S.A. 290.31, Subd. 8 (2) (a). See also Reg. 2031 (8), paragraph (b) (1) (i) (b) for the continuation of a 2-member partnership under certain circumstances after the death of a partner. However, if the decedent partner's estate or other successor sells or exchanges its entire interest in the partnership, or if its entire interest is liquidated, the partnership taxable year with respect to the estate or other successor in interest shall close on the date of such sale or exchange, or the date of completion of the liquidation.

(ii) The last return of a decedent partner shall include only his share of partnership taxable income for any partnership taxable year or years ending within or with the last taxable year for such decedent partner (i.e., the year ending with the date of his death). The distributive share of partnership taxable income for a partnership taxable year ending after the decedent's last taxable year is includible in the return of his estate or other successor in interest. If the estate or other successor in interest of a partner continues to share in the profits or losses of the partnership business, the distributive share thereof is includible in the taxable year of the estate or other successor in interest within or with which the taxable year of the partnership ends. See also Reg. 2031 (17), paragraph (a) (1) (ii). Where the estate or other successor in interest receives distributions, any gain or loss on such distributions is includible in its gross income for its taxable year in which the distribution is made.

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(iii) If a partner (or a retiring partner), in accordance with the terms of the partnership agreement, designates a person to succeed to his interest in the partnership after his death, such designated person shall be regarded as a successor in interest of the deceased for purposes of this chapter. Thus, where a partner designates his widow as the successor in interest, her distributive share of income for the taxable year of the partnership ending within or with her taxable year may be included in a joint return in accordance with the provisions of M.S.A. 290.38.

(iv) If, under the terms of an agreement existing at the date of death of a partner, a sale or exchange of the decedent partner's interest in the partnership occurs upon that date, then the taxable year of the partnership with respect to such decedent partner shall close upon the date of death. See M.S.A. 290.31, Subd. 6 (6) (a). The sale or exchange of a partnership interest does not, for the purpose of this rule, include any transfer of a partnership interest which occurs at death as a result of inheritance or any testamentary disposition.

(v) To the extent that any part of a distributive share of partnership income of the estate or other successor in interest of a deceased partner is attributable to the decedent for the period ending with the date of his death, such part of the distributive share is income in respect of the decedent under M.S.A. 290.077. See M.S.A. 290.077 and the regulations thereunder.

(vi) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). B has a taxable year ending December 31 and is a member of partnership ABC, the taxable year of which ends on June 30. D dies on October 31, 1955. His estate (which as a new taxpayer may, under M.S.A. 290.40 and the regulations thereunder, adopt any taxable year) adopts a taxable year ending October 31. The return of the decedent for the period January 1 to October 31, 1955, will include only his distributive share of taxable income of the partnership for its taxable year ending June 30, 1955. The distributive share of taxable income of the partnership for its taxable year ending June 30, 1956, arising from the interest of the decedent, will be includible in the return of the estate for its taxable year ending October 31, 1956. That part of the distributive share attributable to the decedent for the period ending with the date of his death (July 1 through October 31, 1955) is income in respect of a decedent under M.S.A. 290.077.

Example (2). Assume the same facts as in example (1) of this subdivision, except that, prior to B's death, B and D had agreed that, upon B's death, D would purchase B's interest

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for $10,000. When B dies on October 31, 1955, the partnership taxable year beginning July 1, 1955, closes with respect to him. Therefore, the return for B's last taxable year (January 1 to October 31, 1955) will include his distributive share of taxable income of the partnership for its taxable year ending June 30, 1955, plus his distributive share of partnership taxable income for the period July 1 to October 31, 1955. See subdivision (iv) of this subparagraph.

Example (3). H is a member of a partnership having a taxable year ending December 31. Both H and his wife W are on a calendar year and file joint returns. H dies on March 31, 1955. Administration of the estate is completed and the estate, including the partnership interest, is distributed to W as legatee on November 30, 1955. Such distribution by the estate is not a sale or exchange of H's partnership interest. No part of the taxable income of the partnership for the taxable year ending December 31, 1955, which is allocable to H, will be included in H's taxable income for his last taxable year (January 1 through March 31, 1955) or in the taxable income of H's estate for the taxable year April 1 through November 30, 1955. The distributive share of partnership taxable income for the full calendar year that is allocable to H will be includible in the taxable income of W for her taxable year ending December 31, 1955, and she may file a joint return under M.S.A. 290.38. That part of the distributive share attributable to the decedent for the period ending with the date of his death (January 1 through March 31, 1955) is income in respect of the decedent under M.S.A. 290.077.

Example (4). M is a member of partnership JKM which operates on a calendar year. M and his wife S file joint returns for calendar years. In accordance with the partnership agreement, M designated S to succeed to his interest in the partnership upon his death. M, who had withdrawn $10,000 from the partnership before his death, dies on October 20, 1955. S's distributive share of income for the taxable year 1955 is $15,000 ($10,000 of which represents the amount withdrawn by M). S shall include $15,000 in her income, even though M received $10,000 of this amount before his death. S may file a joint return with M for the year 1955 under M.S.A. 290.38. That part of the $15,000 distributive share attributable to the decedent for the period ending with the date of his death (January 1 through October 20, 1955) is income in respect of a decedent under M.S.A. 290.077.

(4) **Disposition of less than entire interest.** If a partner sells or exchanges a part of his interest in a partnership, or if the interest of a partner is reduced, the partnership taxable year shall continue to its normal end. In such case, the partner's distributive share of items which he is required to include in his taxable income under the provisions of M.S.A. 290.31, Subd. 2 (1)

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shall be determined by taking into account his varying interests in the partnership during the partnership taxable year in which such sale, exchange, or reduction of interest occurred.

(5) **Transfer of interest by gift.** The transfer of a partnership interest by gift does not close the partnership taxable year with respect to the donor. However, the income up to the date of gift attributable to the donor's interest shall be allocated to him under M.S.A. 290.31, Subd. 4 (5) (b).

2031 (7) TRANSACTIONS BETWEEN PARTNER AND PARTNERSHIP.

(a) **Partner not acting in capacity as partner.** A partner who engages in a transaction with a partnership other than in his capacity as a partner shall be treated as if he were not a member of the partnership with respect to such transaction. Such transactions include, for example, loans of money or property by the partnership to the partner or by the partner to the partnership, the sale of property by the partner to the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partnership to the partner or by the partner to the partnership. Where a partner retains the ownership of property but allows the partnership to use such separately owned property for partnership purposes (for example, to obtain credit or to secure firm creditors by guaranty, pledge, or other agreement) the transaction is treated as one between a partnership and a partner not acting in his capacity as a partner. However, transfers of money or property by a partner to a partnership as contributions, or transfers of money or property by a partnership to a partner as distributions, are not transactions included within the provisions of this regulation. In all cases, the substance of the transaction will govern rather than its form. See Reg. 2031 (12) (c) (3).

(b) **Certain sales or exchanges of property with respect to controlled partnerships.—**

(1) **Losses disallowed.** No deduction shall be allowed for a loss on a sale or exchange of property (other than an interest in the partnership), directly or indirectly, between a partnership and a partner who owns, directly or indirectly, more than 50 percent of the capital interest or profits interest in such partnership. A loss on a sale or exchange of property, directly or indirectly, between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits in each partnership shall not be allowed.

(2) **Gains treated as ordinary income.** Any gain recognized upon the sale or exchange, directly or indirectly, of property which, in the hands of the transferee immediately after the transfer, is property other than a capital asset, as defined in

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M.S.A. 290.16, Subd. 3, shall be ordinary income if the transaction is between a partnership and a partner who owns, directly or indirectly, more than 80 percent of the capital interest or profits interest in the partnership. This rule also applies where such a transaction is between partnerships in which the same persons own, directly or indirectly, more than 80 percent of the capital interest or profits interests in each partnership. The term "property other than a capital asset" includes (but is not limited to) trade accounts receivable, inventory, stock in trade, and depreciable or real property used in the trade or business.

(3) **Ownership of capital or profits interest.** For the purpose of M.S.A. 290.31, Subd. 7 (2) and (3) and this paragraph, the ownership of a capital interest or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in M.S.A. 290.10 (6). Under these rules, ownership of a capital or profits interest in a partnership may in certain circumstances be attributed to a person who is not a partner as defined in M.S.A. 290.01, Subd. 3.

(c) **Guaranteed payments.** Payments made by a partnership to a partner for services or for the use of capital are considered as made to a person who is not a partner, to the extent such payments are determined without regard to the income of the partnership. However, a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted such payments as paid or accrued under its method of accounting. See M.S.A. 290.31, Subd. 6 (1) and Reg. 2031 (6) (a). Guaranteed payments are considered as made to one who is not a member of the partnership, only for the purposes of M.S.A. 290.01, Subd. 20 (relating to gross income) and M.S.A. 290.09, Subd. 2 (relating to trade or business expenses). They do not constitute an interest in partnership profits for purposes of M.S.A. 290.31, Subds. 6 (4), 7 (2), and 8 (2), (3), (4). For the purposes of other provisions of the Minnesota Income Tax Act, guaranteed payments are regarded as a partner's distributive share of ordinary income. Thus, a partner who receives guaranteed payments for a period during which he is absent from work because of personal injuries or sickness is not entitled to exclude such payments from his gross income under M.S.A. 290.08, Subd. 5. The provisions of this paragraph may be illustrated by the following examples:

Example (1). Under the ABC partnership agreement, partner A is entitled to a fixed annual payment of $10,000 for services, without regard to the income of the partnership. His distributive share is 10 percent. After deducting the guaranteed payment, the partnership has $50,000 ordinary income. A must include $15,000 as ordinary income for his taxable year within or with which the partnership taxable year ends ($10,000 guaranteed payment plus $5,000 distributive share).

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Example (2). Partner C in the CD partnership is to receive 30 percent of partnership income as determined before taking into account any guaranteed payments, but not less than $10,000. The income of the partnership is $60,000, and C is entitled to $18,000 (30 percent of $60,000) as his distributive share. No part of this amount is a guaranteed payment. However, if the partnership had income of $20,000 instead of $60,000, $6,000 (30 percent of $20,000) would be partner C's distributive share, and the remaining $4,000 payable to C would be a guaranteed payment.

Example (3). Partner X in the XY partnership is to receive a payment of $10,000 for services, plus 30 percent of the taxable income or loss of the partnership. After deducting the payment of $10,000 to partner X, the XY partnership has a loss of $9,000. Of this amount, $2,700 (30 percent of the loss) is X's distributive share of partnership loss and, subject to M.S.A. 290.31, Subd. 4 (4), is to be taken into account by him in his return. In addition, he must report as ordinary income the guaranteed payment of $10,000 made to him by the partnership.

Example (4). Assume the same facts as in example (3) of this paragraph except that, instead of a $9,000 loss, the partnership has $30,000 in capital gains and no other items of income or deduction except the $10,000 paid X as a guaranteed payment. Since the items of partnership income or loss must be segregated under M.S.A. 290.31, Subd. 2 (1), the partnership has a $10,000 ordinary loss and $30,000 in capital gains. X's 30 percent distributive shares of these amounts are $3,000 ordinary loss and $9,000 capital gain. In addition, X has received a $10,000 guaranteed payment with its ordinary income to him.

2031 (8) CONTINUATION OF PARTNERSHIP.

(a) **General rule.** For purposes of M.S.A. 290.31, an existing partnership shall be considered as continuing if it is not terminated.

(b) **Termination.—**

(1) **General rule.—**

(i) A partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. For example, on November 20, 1956, A and B, each of whom is a 20-percent partner in partnership ABC, sell their interests to C, who is a 60-percent partner. Since the business is no longer carried on by any of its partners in a partnership, the ABC partnership is terminated as of November 20, 1956. However, where partners DEF agree on April 30, 1957, to dissolve their partnership, but carry on the business through a winding up period end-

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ing September 30, 1957, when all remaining assets, consisting only of cash, are distributed to the partners, the partnership does not terminate because of cessation of business until September 30, 1957.

(a) Upon the death of one partner in a 2-member partnership, the partnership shall not be considered as terminated if the estate or other successor in interest of the deceased partner continues to share in the profits or losses of the partnership business.

(b) For the continuation of a partnership where payments are being made under M.S.A. 290.31, Subd. 17 (relating to payments to a retiring partner or a deceased partner's successor in interest), see Reg. 2031 (17) (a) (6).

(ii) A partnership shall terminate when 50 percent or more of the total interest in partnership capital and profits is sold or exchanged within a period of 12 consecutive months. Such sale or exchange includes a sale or exchange to another member of the partnership. However, a disposition of a partnership interest by gift (including assignment to a successor in interest), bequest, or inheritance, or the liquidation of a partnership interest, is not a sale or exchange for purposes of this subparagraph. Furthermore, the contribution of property to a partnership does not constitute such a sale or exchange. See, however, Reg. 2031 (12) (c) (3). Fifty percent or more of the total interest in partnership capital and profits means 50 percent or more of the total interest in partnership capital plus 50 percent or more of the total interest in partnership profits. Thus, the sale of a 30-percent interest in partnership capital and a 60-percent interest in partnership profits is not the sale or exchange of 50 percent or more of the total interest in partnership capital and profits. If one or more partners sell or exchange interests aggregating 50 percent or more of the total interest in partnership capital and 50 percent or more of the total interest in partnership profits within a period of 12 consecutive months, such sale or exchange is considered as being within the provisions of this subparagraph. When interests are sold or exchanged on different dates, the percentages to be added are determined as of the date of each sale. For example, with respect to the ABC partnership, the sale by A on May 12, 1956, of a 30-percent interest in capital and profits to D, and the sale by B on March 27, 1957, of a 30-percent interest in capital and profits to E, is a sale of a 50-percent or more interest. Accordingly, the partnership is terminated as of March 27, 1957. However, if on March 27, 1957, D, instead of B, sold his 30-percent interest in capital and profits to E, there would be no termination since only one 30-percent interest would have been sold or exchanged within a 12-month period.

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(iii) For purposes of M.S.A. 290.31, a partnership taxable year closes with respect to all partners on the date on which the partnership terminates. See M.S.A. 290.31, Subd. 6 (5) and Reg. 2031 (6) (c) (1). The date of termination is:

(a) For purposes of M.S.A. 290.31, Subd. 8 (2) (a), the date on which the winding up of the partnership affairs is completed.

(b) For purposes of M.S.A. 290.31, Subd. 8 (2) (b), the date of the sale or exchange of a partnership interest which, of itself or together with sales or exchanges in the preceding 12 months, transfers an interest of 50 percent or more in both partnership capital and profits.

(iv) If a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership distributes its properties to the purchaser and the other remaining partners in proportion to their respective interests in the partnership properties; and, immediately thereafter, the purchaser and the other remaining partners contribute the properties to a new partnership, either for the continuation of the business or for its dissolution and winding up. In the latter case, the new partnership terminates in accordance with subdivision (i) of this subparagraph. See M.S.A. 290.31, Subds. 12 and 13 and Regs. 2031 (12) and 2031 (13)-1. For election of basis adjustments by the purchaser and other remaining partners, see M.S.A. 290.31, Subds. 13 (5) and 20 (2) and Regs. 2031 (13)-1 (d) and 2031 (20) (b).

(2) **Special rules.—**

(i) **Merger or consolidation.** If two or more partnerships merge or consolidate into one partnership, the resulting partnership shall be considered a continuation of the merging or consolidating partnership the members of which own an interest of more than 50 percent in the capital and profits of the resulting partnership. If the resulting partnership can, under the preceding sentence, be considered a continuation of more than one of the merging or consolidating partnerships, it shall, unless the Commissioner permits otherwise, be considered the continuation of that partnership which is credited with the contribution of the greatest dollar value of assets to the resulting partnership. Any other merging or consolidating partnerships shall be considered as terminated. If the members of none of the merging or consolidating partnerships have an interest of more than 50 percent in the capital and profits of the resulting partnership, all of the merged or consolidated partnerships are terminated, and a new partnership results. The taxable years of such merging or consolidating partnerships which are considered terminated shall be closed in accordance with the provisions of M.S.A. 290.31, Subd. 6 (5), (6) and (7), and such partnerships shall file their returns for a taxable year ending upon the date of termination, i.e., the

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date of merger or consolidation. The resulting partnership shall file a return for the taxable year of the merging or consolidating partnership that is considered as continuing. The return shall state that the resulting partnership is a continuation of such merging or consolidating partnership and shall include the names and addresses of the merged or consolidated partnerships. The respective distributive shares of the partners for the periods prior to and subsequent to the date of merger or consolidation shall be shown as a part of the return. The provisions of this subdivision may be illustrated by the following example:

Example. Partnership AB, in whose capital and profits A and B each own a 50-percent interest, and partnership CD, in whose capital and profits C and D each own a 50-percent interest, merge on September 30, 1955, and form partnership ABCD. Partners A, B, C, and D are on a calendar year; partnership AB is also on a calendar year; and partnership CD is on a fiscal year ending June 30th. After the merger, the partners have capital and profit interests as follows: A, 30 percent; B, 30 percent; C, 20 percent and D, 20 percent. Since A and B together own an interest of more than 50 percent in the capital and profits of partnership ABCD, such partnership shall be considered a continuation of partnership AB and shall continue to file returns on a calendar year basis. Since C and D own an interest of less than 50 percent in the capital and profits of partnership ABCD, the taxable year of partnership CD closes as of September 30, 1955, the date of the merger, and CD partnership is terminated as of that date. Partnership ABCD is required to file a return for the taxable year January 1 to December 31, 1955, indicating thereon that, until September 30, 1955, it was partnership AB. Partnership CD is required to file a return for its final taxable year, July 1 through September 30, 1955.

(ii) **Division of a partnership.** Upon the division of a partnership into two or more partnerships, any resulting partnership or partnerships shall be considered a continuation of the prior partnership if its members had an interest of more than 50 percent in the capital and profits of the prior partnership. Any other resulting partnership will not be considered a continuation of the prior partnership but will be considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the divided partnership, the divided partnership is terminated. Where members of a partnership which has been divided into two or more partnerships do not become members of a resulting partnership which is considered a continuation of the prior partnership, such partner's interests shall be considered liquidated as of the date of the division. The resulting partnership that is regarded as continuing shall file a return for the taxable year of the partnership that has been divided. The return shall state that the partnership is a continuation of the

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divided partnership and shall set forth separately the respective distributive shares of the partners for the periods prior to and subsequent to the date of division. The provisions of this subdivision may be illustrated by the following example:

Example. Partnership ABCD is in the real estate and insurance business. A owns a 40-percent interest, and B, C, and D each owns a 20-percent interest, in the capital and profits of the partnership. The partnership and the partners report their income on a calendar year. They agree to separate the real estate and insurance business as of November 1, 1955, and to form two partnerships; partnership AB to take over the real estate business, and partnership CD to take over the insurance business. Since members of resulting partnership AB owned more than a 50-percent interest in the capital and profits of partnership ABCD (A, 40 percent, and B, 20 percent), partnership AB shall be considered a continuation of partnership ABCD. Partnership AB is required to file a return for the taxable year January 1 to December 31, 1955, indicating thereon that until November 1, 1955, it was partnership ABCD. In forming partnership CD, partners C and D may contribute the property distributed to them in liquidation of their entire interests in divided partnership ABCD. Partnership CD will be required to file a return for the taxable year it adopts pursuant to M.S.A. 290.31, Subd. 6 (2), (3), and (4) and Reg. 2031 (6) (b).

2031 (9) NONRECOGNITION OF GAIN OR LOSS ON CONTRIBUTION.

(a) No gain or loss shall be recognized either to the partnership or to any of its partners upon a contribution of property, including installment obligations, to the partnership in exchange for a partnership interest. This rule applies whether the contribution is made to a partnership in the process of formation or to a partnership which is already formed and operating. M.S.A. 290.31, Subd. 9 shall not apply to a transaction between a partnership and a partner not acting in his capacity as a partner since such a transaction is governed by M.S.A. 290.31, Subd. 7. Rather than contributing property to a partnership, a partner may sell property to the partnership or may retain the ownership of property and allow the partnership to use it. In all cases, the substance of the transaction will govern, rather than its form. See Reg. 2031 (12) (c) (3). Thus, if the transfer of property by the partner to the partnership results in the receipt by the partner of money or other consideration, including a promissory obligation fixed in amount and time for payment, the transaction will be treated as a sale or exchange under M.S.A. 290.31, Subd. 7 rather than as a contribution under M.S.A. 290.31, Subd. 9. For the rules governing the treatment of liabilities to which contributed property is subject, see M.S.A. 290.31, Subd. 22 and Reg. 2031 (22).

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(b) (1) Normally, under local law, each partner is entitled to be repaid his contributions of money or other property to the partnership (at the value placed upon such property by the partnership at the time of the contribution) whether made at the formation of the partnership or subsequent thereto. To the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share in partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), M.S.A. 290.31, Subd. 9 does not apply. The value of an interest in such partnership capital so transferred to a partner as compensation for services constitutes income to the partner under M.S.A. 290.01, Subd. 20. The amount of such income is the fair market value of the interest in capital so transferred, either at the time the transfer is made for past services, or at the time the services have been rendered where the transfer is conditioned on the completion of the transferee's future services. The time when such income is realized depends on all the facts and circumstances, including any substantial restrictions or conditions on the compensated partner's right to withdraw or otherwise dispose of such interest. To the extent that an interest in capital representing compensation for services rendered by the decedent prior to his death is transferred after his death to the decedent's successor in interest, the fair market value of such interest is income in respect of a decedent under M.S.A. 290.077.

(2) To the extent that the value of such interest is: (i) compensation for services rendered to the partnership, it is a guaranteed payment for services under M.S.A. 290.31, Subd. 7 (4); (ii) compensation for services rendered to a partner, it is not deductible by the partnership, but is deductible only by such partner to the extent allowable under Chapter 290.

2031 (10) BASIS OF CONTRIBUTING PARTNER'S INTEREST.

The basis to a partner of a partnership interest acquired by a contribution of property, including money, to the partnership shall be the amount of money contributed plus the adjusted basis at the time of contribution of any property contributed. If the acquisition of an interest in partnership capital results in taxable income to a partner, such income shall constitute an addition to the basis of the partner's interest. See Reg. 2031 (9) (b). If the contributed property is subject to indebtedness or if liabilities of the partner are assumed by the partnership, the basis of the contributing partner's interest shall be reduced by the portion of the indebtedness assumed by the other partners, since the partnership's assumption of his indebtedness is treated as a distribution of money to the partner. Conversely, the assumption by the other partners of a portion of the contributor's

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indebtedness is treated as a contribution of money by them. See M.S.A. 290.31, Subd. 22 and Reg. 2031 (22). The provisions of this regulation may be illustrated by the following examples:

Example (1). A acquired a 20 percent interest in a partnership by contributing property. At the time of A's contribution, the property had a fair market value of $10,000, an adjusted basis to A of $4,000 and was subject to a mortgage of $2,000. Payment of the mortgage was assumed by the partnership. The basis of A's interest in the partnership is $2,400, computed as follows:

Adjusted basis to A of property contributed	$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80% of $2,000)	1,600
Basis of A's interest	$2,400

Example (2). If, in example (1) of this regulation, the property contributed by A was subject to a mortgage of $6,000, the basis of A's interest would be zero, computed as follows:

Adjusted basis to A of property contributed	$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80% of $6,000)	$4,800
	($ 800)

Since A's basis cannot be less than zero, the $800 in excess of basis, which is considered as a distribution of money under M.S.A. 290.31, Subd. 22 (2) is treated as capital gain from the sale or exchange of a partnership interest. See M.S.A. 290.31, Subd. 12.

2031 (11) BASIS OF PROPERTY CONTRIBUTED TO A PARTNERSHIP.

The basis to the partnership of property contributed to it by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution. Since such property has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. See M.S.A. 290.16, Subd. 8. For elective adjustments to the basis of partnership property arising from distributions or transfers of partnership interests, see M.S.A. 290.31, Subd. 13 (5), 15 (2), and 20 (2).

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2031 (12) EXTENT OF RECOGNITION OF GAIN OR LOSS ON DISTRIBUTION.

(a) Recognition of gain or loss to partner.—

(1) Recognition of gain.—

(i) Where money is distributed by a partnership to a partner, no gain shall be recognized to the partner except to the extent that the amount of money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. This rule is applicable both to current distributions (i.e., distributions other than in liquidation of an entire interest) and to distributions in liquidation of a partner's entire interest in a partnership. Thus, if a partner with a basis for his interest of $10,000 receives a distribution of cash of $8,000 and property with a fair market value of $3,000, no gain is recognized to him. If $11,000 cash were distributed, gain would be recognized to the extent of $1,000. No gain shall be recognized to a distributee partner with respect to a distribution of property (other than money) until he sells or otherwise disposes of such property, except to the extent otherwise provided by M.S.A. 290.31, Subd. 17 (relating to payments to a retiring partner or a deceased partner's successor in interest) and M.S.A. 290.31, Subd. 21 (relating to unrealized receivables and inventory items). See M.S.A. 290.31, Subd. 12 and paragraph (c) of this regulation.

(ii) For the purpose of M.S.A. 290.31, Subds. 12 and 5, advances or drawings of money or property against a partner's distributive share of income shall be treated as current distributions made on the last day of the partnership taxable year with respect to such partner.

(2) Recognition of loss. Loss is recognized to a partner only upon liquidation of his entire interest in the partnership, and only if the property distributed to him consists solely of money, unrealized receivables (as defined in M.S.A. 290.31, Subd. 21 (3)), and inventory items (as defined in M.S.A. 290.31, Subd. 21 (4) (b)). The term "liquidation of a partner's interest," as defined in M.S.A. 290.31, Subd. 26 (3), is the termination of the partner's entire interest in the partnership by means of a distribution or a series of distributions. Loss is recognized to the distributee partner in such cases to the extent of the excess of the adjusted basis of such partner's interest in the partnership at the time of the distribution over the sum of—

(i) Any money distributed to him, and

(ii) The basis to the distributee, as determined under M.S.A. 290.31, Subd. 13, of any unrealized receivables and inventory items that are distributed to him.

If the partner whose interest is liquidated receives any property other than money, unrealized receivables, or inventory items,

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then no loss will be recognized. Application of the provisions of this subparagraph may be illustrated by the following examples:

Example (1). Partner A has a partnership interest in partnership ABC with an adjusted basis to him of $10,000. He retires from the partnership and receives, as a distribution in liquidation of his entire interest, his share of partnership property. This share is $5,000 cash and inventory with a basis to him (under M.S.A. 290.31, Subd. 13) of $3,000. Partner A realizes a capital loss of $2,000, which is recognized under M.S.A. 290.31, Subd. 12 (2).

Example (2). Partner B has a partnership interest in partnership BCD with an adjusted basis to him of $10,000. He retires from the partnership and receives, as a distribution in liquidation of his entire interest, his share of partnership property. This share is $4,000 cash, real property (used in the trade or business) with an adjusted basis to the partnership of $2,000, and unrealized receivables having a basis to him (under M.S.A. 290.31, Subd. 13) of $3,000. No loss will be recognized to B on the transaction because he received property other than money, unrealized receivables, and inventory items. As determined under M.S.A. 290.31, Subd. 13, the basis to B for the real property received is $3,000.

(3) **Character of gain or loss.** Gain or loss recognized under M.S.A. 290.31, Subd. 12, on a distribution is considered gain or loss from the sale or exchange of the partnership interest of the distributee partner, that is, capital gain or loss.

(b) **Gain or loss recognized by partnership.** A distribution of property (including money) by a partnership to a partner does not result in recognized gain or loss to the partnership under M.S.A. 290.31, Subd. 12. However, recognized gain or loss, may result to the partnership from certain distributions which, under M.S.A. 290.31, Subd. 21 (2), must be treated as a sale or exchange of property between the distributee partner and the partnership.

(c) **Exceptions.—**

(1) M.S.A. 290.31, Subd. 12 does not apply to the extent otherwise provided by—

(i) M.S.A. 290.31, Subd. 17 (relating to payments to a retiring partner or to a deceased partner's successor in interest), and

(ii) M.S.A. 290.31, Subd. 21 (relating to unrealized receivables and inventory items).

For example, payments under M.S.A. 290.31, Subd. 17 (1), which are considered as a distributive share or guaranteed payment, are taxable as such under that section.

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(2) The receipt by a partner from the partnership of money or property under an obligation to repay the amount of such money or to return such property does not consitute a distribution subject to M.S.A. 290.31, Subd. 12, but is a loan governed by M.S.A. 290.31, Subd. 7 (1). To the extent that such an obligation is canceled, the obligor partner will be considered to have received a distribution of money or property at the time of cancellation.

(3) If there is a contribution of property to a partnership and within a short period:

(i) Before or after such contribution other property is distributed to the contributing partner and the contributed property is retained by the partnership, or

(ii) After such contribution the contributed property is distributed to another partner,

such distribution may not fall within the scope of M.S.A. 290.31, Subd. 12. M.S.A. 290.31, Subd. 12 does not apply to a distribution of property, if, in fact, the distribution was made in order to effect an exchange of property between two or more of the partners or between the partnership and a partner. Such a transaction shall be treated as an exchange of property.

2031 (13)-1 BASIS OF DISTRIBUTED PROPERTY OTHER THAN MONEY.

(a) Distributions other than in liquidation of a partner's interest. The basis of property (other than money) received by a partner in a distribution from a partnership, other than in liquidation of his entire interest, shall be its adjusted basis to the partnership immediately before such distribution. However, the basis of the property to the partner shall not exceed the adjusted basis of the partner's interest in the partnership, reduced by the amount of any money distributed to him in the same transaction. The provisions of this paragraph may be illustrated by the following examples:

Example (1). Partner A, with an adjusted basis of $15,000 for his partnership interest, receives in a current distribution property having an adjusted basis of $10,000 to the partnership immediately before distribution, and $2,000 cash. The basis of the property in A's hands will be $10,000. Under M.S.A. 290.31, Subds. 14 and 5, the basis of A's partnership interest will be reduced by the distribution to $3,000 ($15,000, less $2,000 cash, less $10,000, the basis of the distributed property to A).

Example (2). Partner R has an adjusted basis of $10,000 for his partnership interest. He receives a current distribution of $4,000 cash and property with an adjusted basis to the partner-

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ship of $8,000. The basis of the distributed property to partner R is limited to $6,000 ($10,000, the adjusted basis of his interest, reduced by $4,000, the cash distributed).

(b) **Distribution in liquidation.** Where a partnership distributes property (other than money) in liquidation of a partner's entire interest in the partnership, the basis of such property to the partner shall be an amount equal to the adjusted basis of his interest in the partnership reduced by the amount of any money distributed to him in the same transaction. Application of this rule may be illustrated by the following example:

Example. Partner B, with a partnership interest having an adjusted basis to him of $12,000, retires from the partnership and receives cash of $2,000, and real property with an adjusted basis to the partnership of $6,000 and a fair market value of $14,000. The basis of the real property to B is $10,000 (B's basis for his partnership interest, $12,000, reduced by $2,000, the cash distributed).

(c) **Allocation of basis among properties distributed to a partner.—**

(1) Under M.S.A. 290.31, Subd. 13 (2) or (3), the basis to be allocated to properties distributed to a partner shall be allocated first to any unrealized receivable (as defined in M.S.A. 290.31, Subd. 21 (3)) and inventory items (as defined in M.S.A. 290.31, Subd. 21 (4) (b)) included in the distribution. However, such receivables or inventory items may not take a higher basis in the hands of the partner than their common adjusted basis to the partnership immediately before the distribution, unless such distribution is treated as a sale or exchange under M.S.A. 290.31, Subd. 21 (2), or unless the distributee partner has a special basis adjustment for the distributed property under M.S.A. 290.31, Subds. 13 (5) or 20 (2). Any basis not allocated to unrealized receivable or inventory items shall be allocated to any other properties distributed to the partner in the same transaction, in proportion to the bases of such other properties in the hands of the partnership before distribution. The provisions of this subparagraph may be illustrated by the following example:

Example. Partner A, whose partnership interest in partnership ABC has an adjusted basis of $15,000, receives as a distribution in liquidation of his entire interest inventory items having a basis to the partnership of $6,000. In addition, he receives cash of $5,000, and two parcels of real property with adjusted bases to the partnership of $6,000 and $2,000, respectively. Basis in the amount of $10,000 ($15,000 basis, less $5,000 cash received) is allocated $6,000 to inventory items, and $3,000 (6,000/8,000 x $4,000) and $1,000 (2,000/8,000 x $4,000), respectively, to the two parcels of real property.

(2) If the adjusted basis to the partnership of the unrealized receivables and inventory items distributed to a

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partner is greater than the partner's adjusted basis of his interest (reduced by the amount of money distributed to him in the same transaction), the amount of the basis to be allocated to such unrealized receivables and inventory items shall be allocated in proportion to the adjusted bases of such properties in the hands of the partnership. If the basis of the partner's interest to be allocated upon a distribution in liquidation of his entire interest is in excess of the adjusted basis to the partnership of the unrealized receivables and inventory items distributed, and if there is no other property distributed to which such excess can be allocated, the distributee partner sustains a capital loss under M.S.A. 290.31, Subd. 12 (2) to the extent of the unallocated basis of his partnership interest. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Partner C, whose interest in partnership ABC has an adjusted basis to him of $9,000, receives as a distribution in liquidation cash of $6,000, inventory items having an adjusted basis to the partnership of $6,000, and real property having a basis to the partnership of $4,000. The cash payment reduces C's basis to $3,000, which is allocated entirely to inventory items. The real property has a zero basis in C's hands. The partnership bases not carried over to C for the distributed properties are lost unless an election under M.S.A. 290.31, Subd. 24 is in effect requiring the partnership to adjust the bases of remaining partnership properties under M.S.A. 290.31, Subd. 15 (2).

Example (2). Partner B, whose interest in partnership ABC has an adjusted basis to him of $9,000, receives as a distribution in liquidation cash of $1,000 and inventory items having a basis to the partnership of $6,000. The cash payment reduces B's basis to $8,000, which can be allocated only to the extent of $6,000 to the inventory items. The remaining $2,000 basis, not allocable to distributed property, constitutes a capital loss in that amount to partner B under M.S.A. 290.31, Subd. 12 (2). If the election under M.S.A. 290.31, Subd. 24 is in effect, see M.S.A. 290.31, Subd. 15 (2) for adjustment of the basis of undistributed partnership property.

(d) Special partnership basis to transferee under M.S.A. 290.31, Subd. 13 (5).—

(1) (i) A transfer of a partnership interest occurs upon a sale or exchange of an interest or upon the death of a partner. M.S.A. 290.31, Subd. 13 (5) provides a special rule for the determination of the basis of property distributed to a transferee partner who acquired any part of his partnership interest in a transfer with respect to which the election under M.S.A. 290.31, Subd. 24 (relating to the optional adjustment to basis of partnership property) was not in effect.

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(ii) Where an election under M.S.A. 290.31, Subd. 24 is in effect, see M.S.A. 290.31, Subd. 20 (2) and Regs. 2031 (20) (b) and 2031 (13)-2.

(iii) If a transferee partner receives a distribution of property (other than money) from the partnership within 2 years after he acquired his interest or part thereof in the partnership by a transfer with respect to which the election under M.S.A. 290.31, Subd. 24 was not in effect, he may elect to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in M.S.A. 290.31, Subd. 20 (2) were in effect.

(iv) If an election under M.S.A. 290.31, Subd. 13 (5) is made upon a distribution of property to a transferee partner, the amount of the adjustment with respect to the transferee partner is not diminished by any depletion or depreciation on that portion of the basis of partnership property which arises from the special basis adjustment under M.S.A. 290.31, Subd. 13 (5), since depletion or depreciation on such portion for the period prior to distribution is allowed or allowable only if the optional adjustment under M.S.A. 290.31, Subd. 20 (2) is in effect.

(v) If property is distributed to a transferee partner who elects under M.S.A. 290.31, Subd. 13 (5), and if such property is not the same property which would have had a special basis adjustment, then such special basis adjustment shall apply to any like property received in the distribution, provided that the transferee, in exchange for the property distributed, has relinquished his interest in the property with respect to which he would have had a special basis adjustment. This rule applies whether the property in which the transferee has relinquished his interest is retained or disposed of by the partnership. (For shift of transferee's special basis adjustment to like property, see paragraph (b) (2) (ii) of Reg. 2031 (20).)

(vi) The provisions of this subparagraph may be illustrated by the following example:

Example. The basis to transferee partner K of his one-fourth interest in partnership WJKS is $17,000. At the time he acquired such interest by purchase, the election under M.S.A. 290.31, Subd. 24 was not in effect and the partnership inventory had a basis to the partnership of $14,000 and a value of $16,000. K's purchase price reflected $500 of this difference. Thus, $4,000 of the $17,000 paid by K for his one-fourth interest was attributable to his share of partnership inventory with a basis of $3,500. Within 2 years after acquiring his interest, K retired from the partnership and received in liquidation of his entire interest cash of $1,500, inventory with a basis to the partnership of $3,500, property X (a capital asset), with an adjusted basis to the partnership of $2,000, and property Y (a depreciable as-

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set), with an adjusted basis to the partnership of $4,000. The value of the inventory received by K was one-fourth of the value of all partnership inventory and was his share of such property. It is immaterial whether the inventory K received was on hand when K acquired his interest. In accordance with K's election under M.S.A. 290.31, Subd. 13 (5), the amount of his share of partnership basis which is attributable to partnership inventory is increased by $500 (one-fourth of the $2,000 difference between the value of such property, $16,000, and its $14,000 basis to the partnership at the time K acquired his interest). This adjustment under M.S.A. 290.31, Subd. 13 (5) applies only for purpose of distributions to partner K, and not for purpose of partnership depreciation, depletion, or gain or loss on disposition. Thus, the amount to be allocated among the properties received by K in the liquidating distribution is $15,500 ($17,000, K's basis for his interest, reduced by the amount of cash received, $1,500). This amount is allocated as follows: The basis of the inventory items received is $4,000, consisting of the $3,500 common partnership basis for such items, plus the special basis adjustment of $500 which K would have had under M.S.A. 290.31, Subd. 20 (2). The remaining basis of $11,500 ($15,500 minus $4,000) is to be allocated to the remaining property distributed to K in proportion to their adjusted bases to the partnership. Since the adjusted basis to the partnership of property X is $2,000, and that of property Y is $4,000, the $11,500 is allocated $3,833 (2,000/6,000 x $11,500) to X, and $7,667 (4,000/6,000 x $11,500) to Y.

(2) A transferee partner who wishes to elect under M.S.A. 290.31, Subd. 13 (5) shall make the election with his tax return—

(i) For the year of the distribution, if the distribution includes any property subject to the allowance for depreciation, depletion, or amortization, or

(ii) For any taxable year no later than the first taxable year in which the basis of any of the distributed property is pertinent in determining his income tax, if the distribution does not include any such property subject to the allowance for depreciation, depletion or amortization.

(3) A taxpayer making an election under M.S.A. 290.31, Subd. 13 (5) shall submit with the return in which the election is made a schedule setting forth the following:

(i) That under M.S.A. 290.31, Subd. 13 (5) he elects to adjust the basis of property received in a distribution; and

(ii) The computation of the special basis adjustment for the property distributed and the properties to which the adjustment has been allocated. For rules of allocation, see M.S.A. 290.31, Subd. 25.

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(4) A partner who acquired any part of his partnership interest in a transfer to which the election provided in M.S.A. 290.31, Subd. 24 was not in effect, is required to apply the special basis rule contained in M.S.A. 290.31, Subd. 13 (5) to a distribution to him, whether or not made within 2 years after the transfer, if at the time of his acquisition of the transferred interest—

(i) The fair market value of all partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership,

(ii) An allocation of basis under M.S.A. 290.31, Subd. 13 (4) upon a liquidation of his interest immediately after the transfer of the interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization, to property subject to such an allowance, and

(iii) A special basis adjustment under M.S.A. 290.31, Subd. 20 (2) would change the basis to the transferee partner of the property actually distributed.

The application of this rule may be illustrated by the following examples:

Example (1). Partnership ABC owns three parcels of land, each of which has an adjusted basis to the partnership of $5,000 and is worth $55,000, and depreciable property with an adjusted basis and value of $150,000. D purchases A's partnership interest for $105,000 when the election under M.S.A. 290.31, Subd. 24 is not in effect. At the time of D's purchase, the fair market value of all partnership property (other than money) is $315,000, which exceeds 110 percent of $165,000, its adjusted basis to the partnership. Four years later, the partnership is dissolved. D receives one of the three parcels of land which has a basis to the partnership of $5,000, and one-third of the depreciable property with an adjusted basis to the partnership at that time of $45,000, one-third of $135,000 ($150,000 basis, minus $15,000 depreciation computed on the partnership basis. See subparagraph (1) (iv) of this paragraph.) If D's adjusted basis for his interest at the time of the distribution was $100,000 and was allocated under M.S.A. 290.31, Subd. 13 (4) to the property received by him in proportion to their respective basis to the partnership, the basis to him for the distributed land would be $10,000 (5,000/50,000 x $100,000) and the basis of the depreciable property would be $90,000 (45,000/50,000 x $100,000). In effect, D would be attributing to the basis of the depreciable property a portion of the cost of his partnership interest properly attributable to appreciation in nondepreciable property. The application of M.S.A. 290.31, Subd. 20 (2) to the transfer of the interest would have resulted in a different basis to D for the property actually distributed. Therefore, the special basis

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adjustment under M.S.A. 290.31, Subd. 13 (5) must be made so that D must increase the basis of the land by a special basis adjustment of $50,000 ($55,000 fair market value less $5,000 partnership basis), making the basis of his interest therein $55,000 (55,000/100,000 x $100,000). D's basis for the depreciable property will then be $45,000 (45,000/100,000 x $100,000).

Example (2). Assume the same facts as in example (1) of this subparagraph, except that the partnership does not dissolve but distributes one parcel of land to each of the partners in a current distribution. Since the conditions of this subparagraph have been met, D's basis for the distributed land is the adjusted basis such land would have if the adjustment provided in M.S.A. 290.31, Subd. 20 (2) were in effect with respect to the partnership property. Therefore, D's basis for the land is $55,000 ($5,000 basis of the land to the partnership, plus $50,000 special basis adjustment under M.S.A. 290.31, Subd. 13 (5)). D's basis for his partnership interest is reduced by $55,000, his basis for the property distributed.

(e) **Exception.** When a partnership distributes unrealized receivables (as defined in M.S.A. 290.31, Subd. 21 (3)) or substantially appreciated inventory items (as defined in M.S.A. 290.31, Subd. 21 (4)) in exchange for any part of a partner's interest in other partnership property (including money), or, conversely, partnership property(including money) other than unrealized receivables or substantially appreciated inventory items in exchange for any part of a partner's interest in the partnership's unrealized receivables or substantially appreciated inventory items, the distribution will be treated as a sale or exchange of property under the provisions of M.S.A. 290.31, Subd. 21 (2). In such case, M.S.A. 290.31, Subd. 13 (including subsection (5) thereof) applies in determining the partner's basis of the property which he is treated as having sold to or exchanged with the partnership (as constituted after the distribution). The partner is considered as having received such property in a current distribution and, immediately thereafter, as having sold or exchanged it. See M.S.A. 290.31, Subd. 21 (2) and Reg. 2031 (21) (b). However, M.S.A. 290.31, Subd. 13 does not apply in determining the basis of that part of property actually distributed to a partner which is treated as received by him in a sale or exchange under M.S.A. 290.31, Subd. 21 (2). Consequently, the basis of such property shall be its cost to the partner.

2031 (13)-2 SPECIAL PARTNERSHIP BASIS OF DISTRIBUTED PROPERTY.

(a) **Adjustments under M.S.A. 290.31, Subd. 15 (2).** In the case of a distribution of property to a partner, the partnership bases of the distributed properties shall reflect any increases or decreases to the basis of partnership property which have been

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made previously under M.S.A. 290.31, Subd. 15 (2) (relating to the optional adjustment to basis of undistributed partnership property) in connection with previous distributions.

(b) **Adjustments under M.S.A. 290.31, Subd. 20 (2).** In the case of a distribution of property to a partner who acquired any part of his interest in a transfer as to which an election under M.S.A. 290.31, Subd. 24 was in effect, then, for the purposes of M.S.A. 290.31, Subd. 13 (other than subsection (5)), the adjusted partnership bases of the distributed property shall take into account, in addition to any adjustments under M.S.A. 290.31, Subd. 15 (2), the transferee's special basis adjustment for the distributed property under M.S.A. 290.31, Subd. 20 (2). The application of this paragraph may be illustrated by the following example:

Example. Partner D acquired his interest in partnership ABD from a previous partner. Since the partnership had made an election under M.S.A. 290.31, Subd. 24, a special basis adjustment with respect to D is applicable to the basis of partnership property in accordance with M.S.A. 290.31, Subd. 20 (2). One of the assets of the partnership at the time D acquired his interest was property X, which is later distributed to D in a current distribution. Property X has an adjusted basis to the partnership of $1,000 and with respect to D it has a special basis adjustment of $500. Therefore, for purposes of M.S.A. 290.31, Subd. 13 (1), the adjusted basis of such property to the partnership with respect to D immediately before its distribution is $1,500. However, if property X is distributed to partner A, a nontransferee partner, its adjusted basis to the partnership for purposes of M.S.A. 290.31, Subd. 13 (1) is only $1,000. In such case, D's $500 special basis adjustment may shift over to other property. See paragraph (b) (2) (ii) of Reg. 2031 (20).

(c) **Adjustments to basis of distributed inventory and unrealized receivables.** Under M.S.A. 290.31, Subd. 13, the basis to be allocated to distributed properties shall be allocated first to any unrealized receivables and inventory items. If the distributee partner is a transferee of a partnership interest and has a special basis adjustment for unrealized receivables or inventory items under either M.S.A. 290.31, Subd. 20 (2) or M.S.A. 290.31, Subd. 13 (5), then the partnership adjusted basis immediately prior to distribution of any unrealized receivables or inventory items distributed to such partner shall be determined as follows: If the distributee partner receives his entire share of the fair market value of the inventory items or unrealized receivables of the partnership, the adjusted basis of such distributed property to the partnership, for the purposes of M.S.A. 290.31, Subd. 13, shall take into account the entire amount of any special basis adjustment which the distributee partner may have for such assets. If the distributee partner receives less than his entire

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share of the fair market value of partnership inventory items or unrealized receivables, then, for purposes of M.S.A. 290.31, Subd. 13, the adjusted basis of such distributed property to the partnership shall take into account the same proportion of the distributee's special basis adjustment for unrealized receivables or inventory items as the value of such items distributed to him bears to his entire share of the total value of all such items of the partnership. The provisions of this paragraph may be illustrated by the following example:

Example. Partner C acquired his 40-per cent interest in partnership AC from a previous partner. Since the partnership had made an election under M.S.A. 290.31, Subd. 24, C has a special basis adjustment to partnership property under M.S.A. 290.31, Subd. 20 (2). C retires from the partnership when the adjusted basis of his partnership interest is $3,000. He receives from the partnership in liquidation of his entire interest, $1,000 cash, certain capital assets, depreciable property, and certain inventory items and unrealized receivables. C has a special basis adjustment of $800 with respect to partnership inventory items and of $200 with respect to unrealized receivables. The common partnership basis for the inventory items distributed to him is $500 and for the unrealized receivables is zero. If the value of inventory items and the unrealized receivables distributed to C in his 40-per cent share of the total value of all partnership inventory items and unrealized receivables, then, for purposes of M.S.A. 290.31, Subd. 13, the adjusted basis of such property in C's hands will be $1,300 for the inventory items ($500 plus $800) and $200 for the unrealized receivables (zero plus $200). The remaining basis of $500, which constitutes the basis of the capital assets and depreciable property distributed to C, is determined as follows: $3,000 (total basis) less $1,000 cash, or $2,000 (the amount to be allocated to the basis of all distributed property), less $1,500 ($800 and $200 special basis adjustments, plus $500 common partnership basis, the amount allocated to inventory items and unrealized receivables). However, if the value of the inventory items and unrealized receivables distributed to C consisted of only 20 per cent of the total fair market value of such property (i.e., only one-half of C's 40-per cent share), then only one-half of C's special basis adjustment of $800 for partnership inventory items and $200 for unrealized receivables would be taken into account. In that case, the basis of the inventory items in C's hands would be $650 ($250, the common partnership basis for inventory items distributed to him, plus $400, one-half of C's special basis adjustment for inventory items). The basis of the unrealized receivables in C's hands would be $100 (zero plus $100, one-half of C's special basis adjustment for unrealized receivables).

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2031 (14) BASIS OF DISTRIBUTEE PARTNER'S INTEREST.

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's entire interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by the amount of any money distributed to such partner and by the amount of the basis to him of distributed property other than money as determined under M.S.A. 290.31, Subd. 13 and Regs. 2031 (13)-1 and 2031 (13)-2.

2031 (15)-1 OPTIONAL ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY.

(a) **General rule.**—A partnership shall not adjust the basis of partnership property as the result of a distribution of property to a partner, unless the election provided in M.S.A. 290.31, Subd. 24 (relating to optional adjustment to basis of partnership property) is in effect.

(b) **Method of adjustment.—**

(1) **Increase in basis.** Where an election under M.S.A. 290.31, Subd. 24 is in effect and a distribution of partnership property is made, whether or not in liquidation of the partner's entire interest in the partnership, the adjusted basis of the remaining partnership assets shall be increased by—

(i) The amount of any gain recognized under M.S.A. 290.31, Subd. 12 (1) to the distributee partner, or

(ii) The excess of the adjusted basis to the partnership immediately before the distribution of any property distributed (including adjustments under M.S.A. 290.31, Subd. 20 (2) or M.S.A. 290.31, Subd. 13 (5) when applied) over the basis under M.S.A. 290.31, Subd. 13 (including such special basis adjustments) of such property to the distributee partner.

The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Partner A has a basis of $10,000 for his one-third interest in partnership ABC. The partnership has no liabilities and has assets consisting of cash of $11,000 and property with a partnership basis of $19,000 and a value of $22,000. A receives $11,000 in cash in liquidation of his entire interest in the partnership. He has a gain of $1,000 under M.S.A. 290.31, Subd. 12 (1). If the election under M.S.A. 290.31, Subd. 24 is in effect, the partnership basis for the property becomes $20,000 ($19,000 plus $1,000).

Example (2). Partner D has a basis of $10,000 for his one-third interest in partnership DEF. The partnership balance sheet before the distribution shows the following:

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	Assets	
	Adjusted Basis	*Value*
Cash	$ 4,000	$ 4,000
Property X	11,000	11,000
Property Y	15,000	18,000
Totals	$30,000	$33,000
	Liabilities and Capital	
Liabilities	-0-	-0-
Capital: D	$10,000	$11,000
E	10,000	11,000
F	10,000	11,000
Totals	$30,000	$33,000

In liquidation of his entire interest in the partnership, D received property X with a partnership basis of $11,000. D's basis for property X is $10,000 under M.S.A. 290.31, Subd. 13 (3). Where the election under M.S.A. 290.31, Subd. 24 is in effect, the excess of $1,000 (the partnership basis before the distribution less D's basis for property X after distribution) is added to the basis of property Y. The basis of property Y becomes $16,000 ($15,000 plus $1,000). If the distribution is made to a transferee partner who elects under M.S.A. 290.31, Subd. 13 (5), see Reg. 2031 (15)-2.

(2) **Decrease in basis.** Where the election provided in M.S.A. 290.31, Subd. 24 is in effect and a distribution is made in liquidation of a partner's entire interest, the partnership shall decrease the adjusted basis of the remaining partnership property by—

(i) The amount of loss, if any, recognized under M.S.A. 290.31, Subd. 12 (2) to the distributee partner, or

(ii) The excess of the basis of the distributed property to the distributee, as determined under M.S.A. 290.31, Subd. 13 (including adjustments under M.S.A. 290.31, Subd. 20 (2) or M.S.A. 290.31, Subd. 13 (5) when applied) over the adjusted basis of such property to the partnership (including such special basis adjustments) immediately before such distribution.

The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Partner G has a basis of $11,000 for his one-third interest in partnership GHI. Partnership assets consist of cash of $10,000 and property with a basis of $23,000 and a value of $20,000. There are no partnership liabilities. In liquidation of his entire interest in the partnership, G receives $10,000 in cash. He has a loss of $1,000 under M.S.A. 290.31,

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Subd. 12 (2). If the election under M.S.A. 290.31, Subd. 24 is in effect, the partnership basis for the property becomes $22,000 ($23,000 less $1,000).

Example (2). Partner J has a basis of $11,000 for his one-third interest in partnership JKL. The partnership balance sheet before the distribution shows the following:

	Assets	
	Adjusted Basis	*Value*
Cash	$ 5,000	$ 5,000
Property X	10,000	10,000
Property Y	18,000	15,000
Total	$33,000	$30,000
	Liabilities and Capital	
Liabilities	-0-	-0-
Capital: J	$11,000	$10,000
K	11,000	10,000
L	11,000	10,000
Total	$33,000	$30,000

In liquidation of his entire interest in the partnership, J receives property X with a partnership basis of $10,000. J's basis for property X under M.S.A. 290.31, Subd. 13 (3) is $11,000. Where the election under M.S.A. 290.31, Subd. 24, is in effect, the excess of $1,000 ($11,000 basis of property X to J, the distributee, less its $10,000 adjusted basis to the partnership immediately before the distribution) decreases the basis of property Y in the partnership. Thus, the basis of property Y becomes $17,000 ($18,000 less $1,000). If the distribution is made to a transferee partner who elects under M.S.A. 290.31, Subd. 13 (5), see Reg. 2031 (15)-2.

(c) **Allocation of basis.** For allocation among the partnership properties of basis adjustments under M.S.A. 290.31, Subd. 15 (2) and paragraph (b) of this regulation, see M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).

(d) **Returns.** A partnership which must adjust the bases of partnership properties under M.S.A. 290.31, Subd. 15 shall attach a statement to the partnership return for the year of the distribution setting forth the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

2031 (15)-2 ADJUSTMENT AFTER DISTRIBUTION TO TRANSFEREE PARTNER.

(a) In the case of a distribution of property by the partnership to a partner who has obtained all or part of his partnership

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interest by transfer, the adjustments to basis provided in M.S.A. 290.31, Subd. 20 (2) and Subd. 13 (5) shall be taken into account in applying the rules under M.S.A. 290.31, Subd. 15 (2). For determining the adjusted basis of distributed property to the partnership immediately before the distribution where there has been a prior transfer of a partnership interest with respect to which the election provided in M.S.A. 290.31, Subd. 24 or Subd. 13 (5) is in effect, see Regs. 2031 (13)-1 and 2031 (13)-2.

(b) (1) If a transferee partner, in liquidation of his entire partnership interest, receives a distribution of property (including money) with respect to which he has no special basis adjustment, in exchange for his interest in property with respect to which he has a special basis adjustment, and does not utilize his entire special basis adjustment in determining the basis of the distributed property to him under M.S.A. 290.31, Subd. 13, the unused special basis adjustment of the distributee shall be applied as an adjustment to the partnership basis of the property retained by the partnership and as to which the distributee did not use his special basis adjustment. The provisions of this subparagraph may be illustrated by the following example:

Example. Upon the death of his father, partner S acquires by inheritance a half-interest in partnership ACS. Partners A and C each have a one-quarter interest. The assets of the partnership consist of $10,000 cash and land used in farming worth $10,000 with a basis of $1,000 to the partnership. Since the partnership had made the election under M.S.A. 290.31, Subd. 24 at the time of the transfer, partner S has a special basis adjustment of $4,500 under M.S.A. 290.31, Subd. 20 (2) with respect to his undivided half-interest in the real estate. The basis of S's partnership interest, in accordance with M.S.A. 290.31, Subd. 19, is $10,000. S retires from the partnership and receives $10,000 in cash in exchange for his entire interest. Since S has received no part of the real estate, his special basis adjustment of $4,500 will be allocated to the real estate, the remaining partnership property, and will increase its basis to the partnership to $5,500.

(2) The provisions of this paragraph do not apply to the extent that certain distributions are treated as sales or exchanges under M.S.A. 290.31, Subd. 21 (2), (relating to unrealized receivables and substantially appreciated inventory items). See M.S.A. 290.31, Subd. 21 (2) and Reg. 2031 (21) (b).

2031 (16) CHARACTER OF GAIN OR LOSS ON DISPOSITION OF DISTRIBUTED PROPERTY.

(a) Sale or exchange of distributed property.—

(1) Unrealized receivables. Any gain realized or loss sustained by a partner on a sale or exchange or other disposition

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of unrealized receivables (as defined in M.S.A. 290.31, Subd. 21 (3)) received by him in a distribution from a partnership shall be considered gain or loss from the sale or exchange of property other than a capital asset.

(2) **Inventory items.** Any gain realized or loss sustained by a partner on a sale or exchange of inventory items (as defined in M.S.A. 290.31, Subd. 21 (4) (b)) received in a distribution from a partnership shall be considered gain or loss from the sale or exchange of property other than a capital asset if such inventory items are sold or exchanged within 5 years from the date of the distribution by the partnership. The character of any gain or loss from a sale or exchange by the distributee partner of such inventory items after 5 years from the date of distribution shall be determined as of the date of such sale or exchange by reference to the character of the assets in his hands at that date (inventory items, capital assets, property used in a trade or business, etc.).

(b) **Holding period for distributed property.** A partner's holding period for property distributed to him by a partnership shall include the period such property was held by the partnership. The provisions of this paragraph do not apply for the purpose of determining the 5 year period described in M.S.A. 290.31, Subd. 16 (2) and paragraph (a) (2) of this regulation. If the property has been contributed to the partnership by a partner, then the period that the property was held by such partner shall also be included. See M.S.A. 290.16, Subd. 8. For a partnership's holding period for contributed property, see Reg. 2031 (11).

2031 (17) PAYMENTS TO A RETIRING OR A DECEASED PARTNER'S SUCCESSOR IN INTEREST.

(a) **Payments considered as distributive share or guaranteed payment.—**

(1) (i) M.S.A. 290.31, Subd. 17 and this regulation apply only to payments made to a retiring partner or to a deceased partner's successor in interest in liquidation of such partner's entire interest in the partnership. See M.S.A. 290.31, Subd. 26 (3). M.S.A. 290.31, Subd. 17 and this regulation do not apply if the estate or other successor in interest of a deceased partner continues as a partner in its own right under local law. M.S.A. 290.31, Subd. 17 and this regulation apply only to payments made by the partnership and not to transactions between the partners. Thus, a sale by partner A to partner B of his entire one-fourth interest in partnership ABCD would not come within the scope of M.S.A. 290.31, Subd. 17.

(ii) A partner retires when he ceases to be a partner under local law. However, for the purposes of M.S.A. 290.31,

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a retired partner or a deceased partner's successor will be treated as a partner until his interest in the partnership has been completely liquidated.

(2) When payments (including assumption of liabilities treated as a distribution of money under M.S.A. 290.31, Subd. 22) are made to a withdrawing partner, that is, a retiring partner or the estate or other successor in interest of a deceased partner, the amounts paid may represent several items. In part, they may represent the fair market value at the time of his death or retirement of the withdrawing partner's interest in all the assets of the partnership (including inventory) unreduced by partnership liabilities. Also, part of such payments may be attributable to his interest in unrealized receivables and part to an arrangement among the partners in the nature of mutual insurance. When a partnership makes such payments, whether or not related to partnership income, to retire the withdrawing partner's entire interest in the partnership, the payments must be allocated between (i) payments for the value of his interest in assets, except unrealized receivables and, under some circumstances, good will (M.S.A. 290.31, Subd. 17 (2)), and (ii) other payments (M.S.A. 290.31, Subd. 17 (1)). The amounts paid for his interest in assets are treated in the same manner as a distribution in complete liquidation under M.S.A. 290.31, Subds. 12 and 13, and, where applicable, Subd. 21. See Reg. 2031 (21), paragraph (b) (4) (ii). The remaining partners are allowed no deduction for these payments since they represent either a distribution or a purchase of the withdrawing partner's capital interest by the partnership (composed of the remaining partners).

(3) Under M.S.A. 290.31, Subd. 17 (1), the portion of the payments made to a withdrawing partner for his share of unrealized receivables, good will (in the absence of an agreement to the contrary), or otherwise not in exchange for his interest in assets under the rules contained in paragraph (b) of this regulation will be considered either—

(i) A distributive share of partnership income, if the amount of payment is determined with regard to income of the partnership; or

(ii) A guaranteed payment under M.S.A. 290.31, Subd. 7 (4), if the amount of the payment is determined without regard to income of the partnership.

(4) Payments, to the extent considered as a distributive share of partnership income under M.S.A. 290.31, Subd. 17 (1) (a), are taken into account under M.S.A. 290.31, Subd. 2 in the income of the withdrawing partner and thus reduce the amount of the distributive shares of the remaining partners. Payments, to the extent considered as guaranteed payments

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under M.S.A. 290.31, Subd. 17 (1) (b), are deductible by the partnership under M.S.A. 290.09, Subd. 2 and are taxable as ordinary income to the recipient under M.S.A. 290.01, Subd. 20. See M.S.A. 290.31, Subd. 7 (4).

(5) The amount of any payments under M.S.A. 290.31, Subd. 17 (1) shall be included in the income of the recipient for his taxable year with or within which ends the partnership taxable year for which the payment is a distributive share, or in which the partnership is entitled to deduct such amount as a guaranteed payment. On the other hand, payments under M.S.A. 290.31, Subd. 17 (2) shall be taken into account by the recipient for his taxable year in which such payments are made. See paragraph (b) (4) of this regulation.

(6) A retiring partner or a deceased partner's successor in interest receiving payments under M.S.A. 290.31, Subd. 17 is regarded as a partner until the entire interest of the retiring or deceased partner is liquidated. Therefore, if one of the members of a 2-man partnership retires under a plan whereby he is to receive payments under M.S.A. 290.31, Subd. 17, the partnership will not be considered terminated, nor will the partnership year close with respect to either partner, until the retiring partner's entire interest is liquidated, since the retiring partner continues to hold a partnership interest in the partnership until that time. Similarly, if a partner in a 2-man partnership dies, and his estate or other successor in interest receives payments under M.S.A. 290.31, Subd. 17, the partnership shall not be considered to have terminated upon the death of the partner but shall terminate as to both partners only when the entire interest of the decedent is liquidated. See M.S.A. 290.31, Subd. 8 (2), (3) and (4).

(b) **Payments for interest in partnership.—**

(1) Payments made in liquidation of the entire interest of a retiring partner or deceased partner shall, to the extent made in exchange for such partner's interest in partnership property (except for unrealized receivables and good will as provided in subparagraphs (2) and (3) of this paragraph), be considered as a distribution by the partnership (and not as a distributive share or guaranteed payment under M.S.A. 290.31, Subd. 17 (1)). Generally, the valuation placed by the partners upon a partner's interest in partnership property in an arm's length agreement will be regarded as correct. If such valuation reflects only the partner's net interest in the property (i.e., total assets less liabilities), it must be adjusted so that both the value of the partner's interest in property and the basis for his interest take into account the partner's share of partnership liabilities. Gain or loss with respect to distributions under M.S.A.

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290.31, Subd. 17 (2) and this paragraph will be recognized to the distributee to the extent provided in M.S.A. 290.31, Subd. 12 and, where applicable M.S.A. 290.31, Subd. 21.

(2) Payments made to a retiring partner or to the successor in interest of a deceased partner for his interest in unrealized receivables of the partnership in excess of their partnership basis, including any special basis adjustment for them to which such partner is entitled, shall not be considered as made in exchange for such partner's interest in partnership property. Such payments shall be treated as payments under M.S.A. 290.31, Subd. 17 (1) and paragraph (a) of this regulation. For definition of unrealized receivables, see M.S.A. 290.31, Subd. 21 (3).

(3) For the purposes of M.S.A. 290.31, Subd. 17 (2) and this paragraph, payments made to a retiring partner or to a successor in interest of a deceased partner in exchange for the interest of such partner in partnership property shall not include any amount paid for the partner's share of good will of the partnership in excess of its partnership basis, including any special basis adjustments for it to which such partner is entitled, except to the extent that the partnership agreement provides for a reasonable payment with respect to such good will. Such payments shall be considered as payments under M.S.A. 290.31, Subd. 17 (1). To the extent that the partnership agreement provides for a reasonable payment with respect to good will, such payments shall be treated under M.S.A. 290.31, Subd. 17 (2) and this paragraph. Generally, the valuation placed upon good will by an arm's length agreement of the partners, whether specific in amount or determined by a formula, shall be regarded as correct.

(4) Payments made to a retiring partner or to a successor in interest of a deceased partner for his interest in inventory shall be considered as made in exchange for such partner's interest in partnership property for the purposes of M.S.A. 290.31, Subd. 17 (2) and this paragraph. However, payments for an interest in substantially appreciated inventory items, as defined in M.S.A. 290.31, Subd. 21 (4), are subject to the rules provided in M.S.A. 290.31, Subd. 21 (2) and Reg. 2031 (21) (b). The partnership basis in inventory items as to a deceased partner's successor in interest does not change because of the death of the partner unless the partnership has elected the optional basis adjustment under M.S.A. 290.31, Subd. 24. But see paragraph (b) (3) (iii) of Reg. 2031 (21).

(5) Where payments made under M.S.A. 290.31, Subd. 17 are received during the taxable year, the recipient must segregate that portion of each such payment which is determined to be in exchange for the partner's interest in partnership property and treated as a distribution under M.S.A. 290.31, Subd. 17

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(2) from that portion treated as a distributive share or guaranteed payment under M.S.A. 290.31, Subd. 17 (1). Such allocation shall be made as follows—

(i) If a fixed amount (whether or not supplemented by any additional amounts) is to be received over a fixed number of years, the portion of each payment to be treated as a distribution under M.S.A. 290.31, Subd. 17 (2) for the taxable year shall bear the same ratio to the total fixed agreed payment for such year (as distinguished from the amount actually received) as the total fixed agreed payments under M.S.A. 290.31, Subd. 17 (2) bear to the total fixed agreed payments under M.S.A. 290.31, Subd. 17 (1) and (2). The balance, if any, of such amount received in the same taxable year shall be treated as a distributive share or a guaranteed payment under M.S.A. 290.31, Subd. 17 (1) (a) or (b). However, if the total amount received in any one year is less than the amount considered as a distribution under M.S.A. 290.31, Subd. 17 (2) for that year, then any unapplied portion shall be added to the portion of the payments for the following year or years which are to be treated as a distribution under M.S.A. 290.31, Subd. 17 (2). For example, retiring partner W who is entitled to an annual payment of $6,000 for 10 years for his interest in partnership property, receives only $3,500 in 1955. In 1956, he receives $10,000. Of this amount, $8,500 ($6,000 plus $2,500 from 1955) is treated as a distribution under M.S.A. 290.31, Subd. 17 (2) for 1956; $1,500 as a payment under M.S.A. 290.31, Subd. 17 (1).

(ii) If the retiring partner or deceased partner's successor in interest receives payments which are not fixed in amount, such payments shall first be treated as payments in exchange for his interest in partnership property under M.S.A. 290.31, Subd. 17 (2) to the extent of the value of that interest and, thereafter, as payments under M.S.A. 290.31, Subd. 17 (1).

(iii) In lieu of the rules provided in subdivisions (i) and (ii) of this subparagraph, the allocation of each annual payment between M.S.A. 290.31, Subd. 17 (1) and (2) may be made in any manner to which all the remaining partners and the withdrawing partner or his successor in interest agree, provided that the total amount allocated to property under M.S.A. 290.31, Subd. 17 (2) does not exceed the fair market value of such property at the date of death or retirement.

(6) Except to the extent M.S.A. 290.31, Subd. 21 (2) applies, the amount of any gain or loss with respect to payments under M.S.A. 290.31, Subd. 17 (2) for a retiring or deceased partner's interest in property for each year of payment shall be determined under M.S.A. 290.31, Subd. 12. However, where the total of M.S.A. 290.31, Subd. 17 (2) payments is a fixed sum, a retiring partner or a deceased partner's successor in interest may

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elect (in his tax return for the first taxable year for which he receives such payments), to report and to measure the amount of any gain or loss by the difference between—

(i) The amount treated as a distribution under M.S.A. 290.31, Subd. 17 (2) in that year, and

(ii) The portion of the adjusted basis of the partner for his partnership interest attributable to such distribution (i.e., the amount which bears the same proportion to the partner's total adjusted basis for his partnership interest as the amount distributed under M.S.A. 290.31, Subd. 17 (2) in that year bears to the total amount to be distributed under M.S.A. 290.31, Subd. 17 (2)).

A recipient who elects under this subparagraph shall attach a statement to his tax return for the first taxable year for which he receives such payments, indicating his election and showing the computation of the gain included in gross income.

(7) The provisions of this paragraph may be illustrated by the following examples:

Example (1). Partnership ABC is a personal service partnership and its balance sheet is as follows:

Assets

	Adjusted basis per books	Market value
Cash	$13,000	$13,000
Unrealized receivables	0	30,000
Capital and M.S.A. 290.16, Subd. 9 assets	20,000	23,000
Total	$33,000	$66,000

Liabilities and Capital

	Per books	Value
Liabilities	$ 3,000	$ 3,000
Capital:		
A	10,000	21,000
B	10,000	21,000
C	10,000	21,000
Total	$33,000	$66,000

Partner A retires from the partnership in accordance with an agreement whereby his share of liabilities ($1,000) is assumed. In addition he is to receive $9,000 in the year of retirement plus $10,000 in each of the two succeeding years. Thus, the total that A receives for his partnership interest is $30,000 ($29,000 in

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cash and $1,000 in liabilities assumed). Under the agreement terminating A's interest, the value of A's interest in M.S.A. 290.31, Subd. 17 (2) partnership property is $12,000 (one-third of $36,000, the sum of $13,000 cash and $23,000, the fair market value of capital and M.S.A. 290.16, Subd. 9 assets). A's share in unrealized receivables is not included in his interest in partnership property described in M.S.A. 290.31, Subd. 17 (2). Since the basis of A's interest is $11,000 ($10,000 plus $1,000, his share of partnership liabilities), he will realize a capital gain of $1,000 ($12,000 minus $11,000) from the disposition of his interest in partnership property. The remaining $18,000 ($30,000 minus $12,000) will constitute payments under M.S.A. 290.31, Subd. 17 (1) (b) which are taxable to A as guaranteed payments under M.S.A. 290.31, Subd. 7 (4). The payment for the first year is $10,000 consisting of $9,000 in cash, plus $1,000 in liability assumed (M.S.A. 290.31, Subd. 22 (2)). Thus, unless the partners agree otherwise under subparagraph (5) (iii) of this paragraph, each annual payment of $10,000 will be allocated as follows: $6,000 (18,000/30,000 of $10,000) is a M.S.A. 290.31, Subd. 17 (1) (b) payment and $4,000 (12,000/30,000 of $10,000) is a payment for an interest in M.S.A. 290.31, Subd. 17 (2) partnership property. (The partnership may deduct the $6,000 guaranteed payment made to A in each of the 3 years.) The gain on the payments for partnership property will be determined under M.S.A. 290.31, Subd. 12, as provided in subparagraph (6) of this paragraph. A will treat only $4,000 of each payment as a distribution in a series in liquidation of his entire interest and, under M.S.A. 290.31, Subd. 12, will have a capital gain of $1,000 when the last payment is made. However, if A so elects, as provided in subparagraph (6) of this paragraph, he may treat such gain as follows: Of each $4,000 payment attributable to A's interest in partnership property, $333 is capital gain (one-third of the total capital gain of $1,000), and $3,667 is a return of capital.

Example (2). Assume the same facts as in example (1) of this subparagraph except that the agreement between the partners provides for payments to A for 3 years of a percentage of annual income instead of a fixed amount. Unless the partners agree otherwise under subparagraph (5) (iii) of this paragraph, all payments received by A up to $12,000 shall be treated under M.S.A. 290.31, Subd. 17 (2) as payments for A's interest in partnership property. His gain of $1,000 will be taxed only after he has received his full basis under M.S.A. 290.31, Subd. 12. Since the payments are not fixed in amount, the election provided in subparagraph (6) of this paragraph is not available. Any payments in excess of $12,000 shall be treated as a distributive share of partnership income to A under M.S.A. 290.31, Subd. 17 (1) (a).

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Example (3). Assume the same facts as in example (1) of this subparagraph except that the partnership agreement provides that the payment for A's interest in partnership property shall include payment for his interest in the good will of the partnership. At the time of A's retirement, the partners determine the value of partnership good will to be $9,000. The value of A's interest in partnership property described in M.S.A. 290.31, Subd. 17 (2) is thus $15,000 (one-third of $45,000, the sum of $13,000 cash, plus $23,000, the value of capital and M.S.A. 290.16, Subd. 9 assets, plus $9,000 good will). From the disposition of his interest in partnership property, A will realize a capital gain of $4,000 ($15,000, minus $11,000, the basis of his interest). The remaining $15,000 ($30,000 minus $15,000) will constitute payments under M.S.A. 290.31, Subd. 17 (1) (b) which are taxable to A as guaranteed payments under M.S.A. 290.31, Subd. 7 (4).

(c) **Cross reference.** See M.S.A. 290.31, Subd. 23 for treatment of payments under M.S.A. 290.31, Subd. 17 (1) as income in respect of a decedent under M.S.A. 290.077.

2031 (18) RECOGNITION AND CHARACTER OF GAIN OR LOSS ON SALE OR EXCHANGE.

(a) The sale or exchange of an interest in a partnership shall, except to the extent M.S.A. 290.31, Subd. 21 (1) applies, be treated as the sale or exchange of a capital asset, resulting in capital gain or loss measured by the difference between the amount realized and the adjusted basis of the partnership interest, as determined under M.S.A. 290.31, Subd. 5. For treatment of selling partner's distributive share up to date of sale, see M.S.A. 290.31, Subd. 6 (6) and (7). Where the provisions of M.S.A. 290.31, Subd. 21 require the recognition of ordinary income or loss with respect to a portion of the amount realized from such sale or exchange, the amount realized shall be reduced by the amount attributable under M.S.A. 290.31, Subd. 21 to unrealized receivables and substantially appreciated inventory items, and the adjusted basis of the transferor partner's interest in the partnership shall be reduced by the portion of such basis attributable to such unrealized receivables and substantially appreciated inventory items. See M.S.A. 290.31, Subd. 21 and Reg. 2031 (21).

(b) M.S.A. 290.31, Subd. 18 shall apply whether the partnership interest is sold to one or more members of the partnership or to one or more persons who are not members of the partnership. M.S.A. 290.31, Subd. 18 shall also apply even though the sale of the partnership interest results in a termination of the partnership under M.S.A. 290.31, Subd. 8 (2), (3) and (4). Thus, the provisions of M.S.A. 290.31, Subd. 18 shall be applicable (1) to the transferor partner in a 2-man partnership when he

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sells his interest to the other partner, and (2) to all the members of a partnership when they sell their interest to one or more persons outside the partnership.

(c) See M.S.A. 290.13, Subd. 1 (5) for nonrecognition of gain or loss upon transfer of a partnership interest to a corporation controlled by the transferor.

2031 (19) BASIS OF TRANSFEREE PARTNER'S INTEREST.

The basis to a transferee partner of an interest in a partnership shall be determined under the general basis rules for property provided under M.S.A. 290.12, 290.14, 290.15 and 290.16. Thus, the basis of a purchased interest will be its cost. The basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death, increased by his estate's or other successor's share of partnership liabilities, if any, on that date, and reduced to the extent that such value is attributable to items constituting income in respect of a decedent (see M.S.A. 290.31, Subd. 23 and Regs. 2031 (6), paragraph (c) (3) (v) and 2031 (23) (b)) under M.S.A. 290.077. For basis of contributing partner's interest, see M.S.A. 290.31, Subd. 10. The basis so determined is then subject to the adjustments provided in M.S.A. 230.31, Subd. 5.

2031 (20) OPTIONAL ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY.

(a) **General rule.** The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, unless the election provided by M.S.A. 290.31, Subd. 24 (relating to optional adjustment to basis of partnership property) is in effect with respect to the partnership. However, whether or not the election provided in M.S.A. 290.31, Subd. 24 is in effect, the basis of partnership property shall not be adjusted as the result of a contribution of property, including money, to the partnership.

(b) **Adjustment to basis of partnership property.—**

(1) **Determination of adjustment.** In the case of a transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, a partnership as to which the election under M.S.A. 290.31, Subd. 24 is in effect shall—

(i) Increase the adjusted basis of partnership property by the excess of the transferee's basis for his partnership interest over his share of the adjusted basis to the partnership of all partnership property, or

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(ii) Decrease the adjusted basis of partnership property by the excess of the transferee partner's share of the adjusted basis of all partnership property over his basis for his partnership interest.

The amount of the increase or decrease constitutes an adjustment affecting the basis of partnership property with respect to the transferee partner only. Thus, for purposes of depreciation, depletion, gain or loss, and distributions, the transferee partner will have a special basis for those partnership properties which are adjusted under M.S.A. 290.31, Subd. 20 (2) and this paragraph. This special basis is his share of the common partnership basis (i.e., the adjusted basis of such properties to the partnership without regard to any special basis adjustment of any transferee) plus or minus his special basis adjustments. A partner's share of the adjusted basis of partnership property is equal to the sum of his interest as a partner in partnership capital and surplus, plus his share of partnership liabilities. Where an agreement with respect to contributed property is in effect under M.S.A. 290.31, Subd. 4 (3) (b), such agreement shall be taken into account in determining a partner's share of the adjusted basis of partnership property. Generally, if a partner's interest in partnership capital and profits is ⅓, his share of the adjusted basis of partnership property will be ⅓ of such basis. The provisions of this paragraph may be illustrated by the following examples:

Example (1). A is a member of partnership ABC in which the partners have equal interests in capital and profits. The partnership has made the election under M.S.A. 290.31, Subd. 24, relating to the optional adjustment to the basis of partnership property. A sells his interest to P for $22,000. The balance sheet of the partnership at the date of sale shows the following:

Assets

	Adjusted Basis Per Books	Market Value
Cash	$ 5,000	$ 5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Depreciable assets	20,000	40,000
Total	$55,000	$76,000

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Liabilities and Capital

	Adjusted Basis Per Books	Value
Liabilities	$10,000	$10,000
Capital:		
A	15,000	22,000
B	15,000	22,000
C	15,000	22,000
Total	$55,000	$76,000

The amount of the adjustment under M.S.A. 290.31, Subd. 20 (2) is the difference between the basis of the transferee's interest in the partnership and his share of the adjusted basis of partnership property. Under M.S.A. 290.31, Subd. 19, the basis of P's interest is $25,333 (the cash paid for A's interest, $22,000 plus $3,333, P's share of partnership liabilities). P's share of the adjusted basis of partnership property is $18,333, i.e., $15,000 plus $3,333. The amount to be added to the basis of partnership property is, therefore, $7,000, the difference between $25,333 and $18,333. This amount will be allocated to partnership properties in accordance with the rules set forth in M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).

Example (2). D is a member of partnership DEF in which the partners have equal interests in profits, but not in capital. The partnership has made the election under M.S.A. 290.31, Subd. 24. D dies and his interest passes to W, his widow. The balance sheet of the partnership at the date of D's death shows the following:

Assets

	Adjusted Basis Per Books	Market Value
Cash	$ 7,000	$ 7,000
Accounts receivable	10,000	10,000
Inventory	20,000	24,000
Depreciable assets	20,000	40,000
Total	$57,000	$81,000

Liabilities and Capital

	Adjusted Basis Per Books	Value
Liabilities	$10,000	$10,000
Capital:		
D	18,000	26,000
E.	15,000	23,000
F	14,000	22,000
Total	$57,000	$81,000

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The amount of the adjustment under M.S.A. 290.31, Subd. 20 (2) is the difference between the basis of the transferee's interest in the partnership and her share of the adjusted basis of partnership property. Under M.S.A. 290.31, Subd. 19, the basis of W's interest is $29,333 (the fair market value of D's interest at his death, $26,000, plus $3,333, his share of partnership liabilities). W's share of the adjusted basis of partnership property is $21,333 (i.e., $18,000 plus $3,333, her share of partnership liabilities). The amount to be added to the basis of partnership property is, therefore, $8,000, the difference between $29,333 and $21,333. This amount will be allocated to partnership properties in accordance with the rules set forth in M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).

Note that in examples (1) and (2) of this subparagraph the amount of the adjustment does not depend upon the adjusted basis to the transferor for his interest in partnership capital.

(2) **Determination of partner's share of adjusted basis of partnership property.**—

(i) Under the provisions of M.S.A. 290.31, Subd. 20 (2), a partner's share of the adjusted basis of partnership property shall be determined by taking into account the effect of any partnership agreement with respect to contributed property as described in M.S.A. 290.31, Subd. 4 (3) (b), or the effect of the contribution of undivided interests under M.S.A. 290.31, Subd. 4 (3) (c). This rule may be illustrated by the following examples:

Example (1). A, B, and C form partnership ABC, to which A contributes land worth $1,000 (property X) with an adjusted basis to him of $400, and B and C each contributes $1,000 cash. Each partner has $1,000 credited to him on the books of the partnership as his capital contribution. The partners share in profits equally. During the partnership's first taxable year, property X appreciates in value to $1,300. A sells his one-third interest in the partnership to D for $1,100, when the election under M.S.A. 290.31, Subd. 24 is in effect. No agreement under M.S.A. 290.31, Subd. 4 (3) (b) is in effect. The adjusted basis of the partnership property is increased with respect to D by the excess of his basis for his partnership interest, $1,100, over his share of the adjusted basis of partnership property, $800 (⅓ of $2,400, the total adjusted basis of partnership property). The amount of the adjustment, therefore, is $300 ($1,100 minus $800), which is an increase in the basis of partnership property with respect to D only. This special basis adjustment will be allocated to property X. (See M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).) If property X is sold for $1,600, the gain to the partnership is $1,200 ($1,600 received, less the adjusted common partnership basis of $400 for property X). Thus, each partner's distributive share of the gain on the sale is $400. However, D's

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recognized gain is only $100 (his $400 distributive share of the gain, reduced by $300, his special basis adjustment with respect to property X). If D purchased his interest from B or C, the partners who contributed cash, D's adjustment under M.S.A. 290.31, Subd. 20 (2) would also be $300, computed in exactly the same manner as in the case of a purchase from A.

Example (2). Assume that partnership ABC described in example (1) of this subdivision has an agreement under M.S.A. 290.31, Subd. 4 (3) (b) with respect to property X, stating that upon the sale of that property any gain, to the extent attributable to the precontribution appreciation of $600 (the difference between its value, $1,000, and its basis, $400, at the time of the contribution) is to be allocated entirely to A, who contributed property X. Upon the purchase of A's interest by D for $1,100, the computation of D's special basis would differ from that indicated in example (1) of this subdivision as follows: Under the partnership agreement, A's share of the $2,400 adjusted basis of partnership property is only $400 (his basis for property X prior to its contribution to the partnership), and B's and C's share is $1,000 each (the amount of the cash investment of each). The amount of the increase to D in the adjusted basis of partnership property under M.S.A. 290.31, Subd. 20 (2) (a) is $700 (the excess of $1,100, D's cost basis for his interest, over $400, A's share of the adjusted basis of partnership property to which D succeeds). This amount constitutes an adjustment to the basis of partnership property with respect to D only. If X is sold by the partnership for $1,600, the gain is $1,200 ($1,600 received less the adjusted common partnership basis of $400). Under the partnership agreement, $600 of this gain, which is attributable to precontribution appreciation in value, is allocable to D, who is A's successor. The remaining $600 gain is not subject to the agreement and is allocable to the partners equally, $200 each. D's distributive share of the partnership gain is thus $600 plus $200, or $800. However, D has a special basis adjustment of $700 under M.S.A. 290.31, Subd. 20 (2) (a), which reduces his gain from $800 to $100. B and C each has a gain of $200, which is unaffected by the transfer of A's interest to D.

Example (3). Assume the same facts as in example (2) of this subdivision, except that D has purchased his interest from B instead of from A. His special basis adjustment for partnership property in this case differs from that where he had purchased his interest from A, because of the effect of the agreement under M.S.A. 290.31, Subd. 4 (3) (b). In this case, D is a successor to B, whose share of the adjusted basis of partnership property is $1,000, instead of A, whose share is only $400. As a result, the adjustment under M.S.A. 290.31, Subd. 20 (2) (a) is the excess of D's cost basis for his interest, $1,100, over

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his share of the adjusted basis of partnership property, $1,000, or $100. In this case, if property X is sold for $1,600, the partnership gain is $1,200 ($1,600 less the adjusted partnership basis of $400). Of this gain, $600, representing precontribution appreciation, is allocable to A under the partnership agreement. The remaining $600 is allocable in the amount of $200 to each partner. Since D as a transferee has a special basis adjustment of $100 under M.S.A. 290.31, Subd. 20 (2) (a), his gain is reduced from $200 to $100.

(ii) If a partner receives a distribution of property with respect to which another partner has a special basis adjustment, the distributee shall not take into account the special basis adjustment of the other partner. However, the partner with the special basis adjustment will reallocate it under M.S.A. 290.31, Subd. 25 to remaining partnership property of a like kind or, if he receives a distribution of like property, to such distributed property. If a partner receives a distribution of property with respect to which he has a special basis adjustment, such basis adjustment will be taken into account when relevant under M.S.A. 290.31, Subd. 13. See Reg. 2031 (13)-2 (b). If, at the time a partner receives property (whether or not he has a special basis adjustment with respect to such property), he relinquishes his interest in other property of a like kind with respect to which he has a special basis adjustment, the adjusted basis to the partnership of the distributed property shall include his special basis adjustment for the property in which he relinquished his interest. For the purposes of the preceding sentence, a partner will be considered as having relinquished his interest in any remaining partnership properties when his interest has been completely liquidated; however, when a partner receives a distribution not in liquidation, he will be considered as relinquishing his interest only in property distributed to other partners. For the purposes of this subdivision, like property means property of the same class, that is, stock in trade, property used in the trade or business, capital assets, etc. For certain adjustments to the basis of remaining partnership property after a distribution to a transferee partner, see Reg. 2031 (13)-2 (b). The provisions of this subdivision may be illustrated by the following examples:

Example (1). C is a transferee partner in partnership BC. The partnership owns, among other assets, X, a depreciable asset with a common basis to the partnership of $1,000 and a special basis adjustment to C of $200, and Y, another depreciable asset with a common basis of $800 and a special basis adjustment to C of $300. B and C agree that B will receive a distribution of property Y, and C will receive a distribution of property X, with all other property to remain in the partnership. With respect to B, the partnership basis of property Y is $800, the common partnership basis. Y will, therefore, have a basis of

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$800 in B's hands under M.S.A. 290.31, Subd. 13 (1) which provides for the use of a carry-over basis in the case of current distributions. With respect to C, however, the partnership basis of property X is $1,500, the common partnership basis of $1,000, plus C's special basis adjustment of $200 for property X, plus C's additional special basis adjustment of $300 for property Y, in which he has relinquished his interest.

Example (2). (a) Partner D acquired his one-third interest in partnership BCD for $14,000 from a previous partner when an election under M.S.A. 290.31, Subd. 24 was in effect. Therefore, under M.S.A. 290.31, Subd. 20 (2), D has a special basis adjustment for certain partnership property. Assume that at the time of the distribution in paragraph (b) of this example, the partnership assets consist of cash and rental property and that such assets and D's special basis adjustments under M.S.A. 290.31, Subd. 20 (2) are as follows:

Item	Fair Market Value	Common Partnership Basis	D's Share	D's Special Basis Adjustment	Partnership Basis to D
Cash	$12,000	$12,000	$ 4,000	.....	$ 4,000
House U....	9,000	1,200	400	.....	400
V....	6,000	4,500	1,500	.....	1,500
W....	8,000	1,500	500	.....	500
X....	9,000	4,800	1,600	$2,000	3,600
Y....	9,000	6,000	2,000	.....	2,000
Z....	7,000	3,000	1,000	1,000	2,000
	$60,000	$33,000	$11,000	$3,000	$14,000

(b) Assume further that D receives $4,000 in cash and houses Y and Z in complete liquidation of his interest in partnership BCD. In determining the basis to D of houses Y and Z under M.S.A. 290.31, Subd. 13 (3) and (4), D must allocate $10,000 basis ($14,000 basis for his interest, less $4,000 cash received) to houses Y and Z in proportion to their adjusted bases to the partnership. For purposes of M.S.A. 290.31, Subd. 13 (4), the adjusted basis of house Y is $7,200. ($6,000 common partnership basis, plus $1,200, allocated share of D's special basis adjustment of $2,000 for house X, in which D relinquished his interest). The adjusted basis of house Z is $4,800 ($3,000 common partnership basis, plus $1,000, D's special basis for house Z, plus $800, allocated share of D's special basis of $2,000 for house X, in which D relinquished his interest). See subparagraph (2) (ii) of this paragraph under which $6,000/10,000 of the $2,000 special basis adjustment for X is allocated to Y and 4,000/10,000 of such amount to Z. Therefore, $6,000 basis (7,200/12,000 of $10,000) is allocated to house Y and $4,800 basis (4,800/12,000 of $10,000) to house Z.

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(c) Since houses Y and Z had $12,000 basis to the partnership, as computed in paragraph (b) of this example, and only $10,000 basis to D, as determined under M.S.A. 290.31, Subd. 13, the partnership, under M.S.A. 290.31, Subd. 15 (2) (a), must increase the basis of remaining partnership property (houses U, V, W, and X) by $2,000 (excess of $12,000 over $10,000). For allocation of this amount, see M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).

(iii) Where an adjustment is made under M.S.A. 290.31, Subd. 20 (2) to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for each partner, including the transferee partner, based on his interest in such property. See paragraph (a) (5) of Reg. 2031 (2)-1.

(iv) Where there has been more than one transfer of partnership interests, the last transferee's special basis adjustment, if any, under M.S.A. 290.31, Subd. 20 (2) shall be determined by reference to the partnership common basis for its property without regard to any prior transferee's special basis adjustment. For example, A, B, and C form a partnership. A and B each contribute $1,000 cash and C contributes land with a basis and value of $1,000. When the land has appreciated in value to $1,300, A sells his interest to D for $1,100 (1/3 of $3,300, the value of the partnership property). The election under M.S.A. 290.31, Subd. 24 is in effect; therefore, D has a special basis adjustment of $100 with respect to the land under M.S.A. 290.31, Subd. 20 (2). After the land has further appreciated in value to $1,600, D sells his interest to E for $1,200 (1/3 of $3,600, the value of the partnership property). Under M.S.A. 290.31, Subd. 20 (2), E has a special basis adjustment of $200. This amount is determined without regard to any special basis adjustment that D may have had in the partnership assets.

(3) **Returns.** A transferee partner who has a special basis adjustment under M.S.A. 290.31, Subd. 20 (2) shall attach a statement to his income tax return for the first taxable year in which the basis of any partnership property subject to the adjustment is pertinent in determining his income tax, showing the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(c) Allocation of basis. For the allocation of basis among partnership properties where M.S.A. 290.31, Subd. 20 (2) applies, see M.S.A. 290.31, Subd. 25 and Reg. 2031 (25).

2031 (21) UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) Sale or exchange of interest in a partnership.—

(1) **Character of amount realized.** To the extent that money or property received by a partner in exchange for all or

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part of his partnership interest is attributable to his share of the value of partnership unrealized receivables or substantially appreciated inventory items, the money or fair market value of the property received shall be considered as an amount realized from the sale or exchange of property other than a capital asset. The remainder of the total amount realized on the sale or exchange of the partnership interest is realized from the sale or exchange of a capital asset under M.S.A. 290.31, Subd. 18. For definition of "unrealized receivables" and "inventory items which have appreciated substantially in value," see M.S.A. 290.31, Subd. 21 (3) and (4). Unrealized receivables and substantially appreciated inventory items are hereafter in this regulation referred to as "M.S.A. 290.31, Subd. 21 property." See paragraph (e) of this regulation.

(2) **Determination of gain or loss.** The income or loss realized by a partner upon the sale or exchange of his interest in M.S.A. 290.31, Subd. 21 property is the difference between (i) the portion of the total amount realized for the partnership interest allocated to M.S.A. 290.31, Subd. 21 property, and (ii) the portion of the selling partner's basis for his entire interest allocated to such property. Generally, the portion of the total amount realized which the seller and the purchaser allocate to M.S.A. 290.31, Subd. 21 property in an arm's length agreement will be regarded as correct. The portion of the partner's adjusted basis for his partnership interest to be allocated to M.S.A. 290.31, Subd. 21 property shall be an amount equal to the basis such property would have had under M.S.A. 290.31, Subd. 13 (including subsection (5) thereof) if the selling partner had received his share of such properties in a current distribution made immediately before the sale. See Regs. 2031 (13)-1 and 2031 (13)-2. Such basis shall reflect the rules of M.S.A. 290.31, Subd. 4 (3) (c), if applicable, or any agreement under M.S.A. 290.31, Subd. 4 (3) (b). Any gain or loss recognized which is attributable to M.S.A. 290.31, Subd. 21 property will be ordinary gain or loss. The difference between the remainder, if any, of the partner's adjusted basis for his partnership interest and the balance, if any, of the amount realized is the transferor's capital gain or loss on the sale of his partnership interest.

(3) **Statement required.** A transferor partner selling or exchanging any part of his interest in a partnership which has any M.S.A. 290.31, Subd. 21 property at the time of sale or exchange shall submit with his income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information:

(i) The date of the sale or exchange, the amount of the transferor partner's adjusted basis for his partnership interest, and the portion thereof attributable to M.S.A. 290.31, Subd. 21 property under M.S.A. 290.31, Subd. 13; and

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(ii) The amount of any money and the fair market value of any other property received or to be received for the transferred interest in the partnership, and the portion thereof attributable to M.S.A. 290.31, Subd. 21 property.

(iii) If the transferor partner computes his adjusted basis for M.S.A. 290.31, Subd. 21 property under the provisions of M.S.A. 290.31, Subd. 13 (5), he must also include in the statement the information required by paragraph (d) (3) of Reg. 2031 (13)-1.

(iv) If the transferor partner has a special basis adjustment under M.S.A. 290.31, Subd. 20 (2), he must also include in the statement the computation of his special basis adjustment and the partnership properties to which the adjustment has been allocated.

(b) **Certain distributions treated as sales or exchanges.—**

(1) **In general.—**

(i) Certain distributions to which M.S.A. 290.31, Subd. 21 (2) applies are treated in part as sales or exchanges of property between the partnership and the distributee partner, and not as distributions to which M.S.A. 290.31, Subds. 12 through 17 apply. A distribution treated as a sale or exchange under M.S.A. 290.31, Subd. 21 (2) is not subject to the provisions of M.S.A. 290.31, Subd. 7 (2) and (3). M.S.A. 290.31, Subd. 21 (2) applies whether or not the distribution is in liquidation of the distributee partner's entire interest in the partnership. However, M.S.A. 290.31, Subd. 21 (2) applies only to the extent that a partner either receives M.S.A. 290.31, Subd. 21 property in exchange for his relinquishing any part of his interest in other property, or receives other property in exchange for his relinquishing any part of his interest in M.S.A. 290.31, Subd. 21 property.

(ii) M.S.A. 290.31, Subd. 21 (2) does not apply to a distribution to a partner which is not in exchange for his interest in other partnership property. Thus, M.S.A. 290.31, Subd. 21 (2) does not apply to the extent that a distribution consists of the distributee partner's share of M.S.A. 290.31, Subd. 21 property or his share of other property. Similarly, M.S.A. 290.31, Subd. 21 (2) does not apply to current drawings or to advances against the partner's distributive share, or to a distribution which is, in fact, a gift or payment for services or for the use of capital. In determining whether a partner has received only his share of either M.S.A. 290.31, Subd. 21 property or of other property, his interest in such property remaining in the partnership immediately after a distribution must be taken into account. For example, the M.S.A. 290.31, Subd. 21 property in partnership ABC has a fair market value of $100,000 in which partner A has an interest of 30 per cent, or $30,000. If A receives $20,000

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of M.S.A. 290.31, Subd. 21 property in a distribution, and continues to have a 30 per cent interest in the $80,000 of M.S.A. 290.31, Subd. 21 property remaining in the partnership after the distribution, only $6,000 ($30,000 minus $24,000 (30 per cent of $80,000)) of M.S.A. 290.31, Subd. 21 property received by him will be considered to be his share of such property. The remaining $14,000 ($20,000 minus $6,000) received is in excess of his share.

(iii) If a distribution is, in part, a distribution of the distributee partner's share of M.S.A. 290.31, Subd. 21 property, or of other property (including money) and, in part, a distribution in exchange of such properties, the distribution shall be divided for the purpose of applying M.S.A. 290.31, Subd. 21 (2). The rules of M.S.A. 290.31, Subd. 21 (2) shall first apply to the part of the distribution treated as a sale or exchange of such properties, and then the rules of M.S.A. 290.31, Subds. 12 through 17 shall apply to the part of the distribution not treated as a sale or exchange. See paragraph (b) (4) (ii) of this regulation for treatment of payments under M.S.A. 290.31, Subd. 17 (1).

(2) Distribution of M.S.A. 290.31, Subd. 21 property (unrealized receivables or substantially appreciated inventory items).—

(i) To the extent that a partner receives M.S.A. 290.31, Subd. 21 property in a distribution in exchange for any part of his interest in partnership property (including money) other than M.S.A. 290.31, Subd. 21 property, the transaction shall be treated as a sale or exchange of such properties between the distributee partner and the partnership (as constituted after the distribution).

(ii) At the time of the distribution, the partnership (as constituted after the distribution) realizes ordinary income or loss on the sale or exchange of the M.S.A. 290.31, Subd. 21 property. The amount of the income or loss to the partnership will be measured by the difference between the adjusted basis to the partnership of the M.S.A. 290.31, Subd. 21 property considered as sold to or exchanged with the partner, and the fair market value of the distributee partner's interest in other partnership property which he relinquished in the exchange. In computing the partners' distributive shares of such ordinary income or loss, the income or loss shall be allocated only to partners other than the distributee and separately taken into account under M.S.A. 290.31, Subd. 2 (1) (f).

(iii) At the time of the distribution, the distributee partner realizes gain or loss measured by the difference between his adjusted basis for the property relinquished in the exchange (including any special basis adjustment which he may have) and the fair market value of the M.S.A. 290.31, Subd. 21 property received by him in exchange for his interest in other property

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which he has relinquished. The distributee's adjusted basis for the property relinquished is the basis such property would have had under M.S.A. 290.31, Subd. 13 (including subsection (5) thereof) if the distributee partner had received such property in a current distribution immediately before the actual distribution which is treated wholly or partly as a sale or exchange under M.S.A. 290.31, Subd. 21 (2). The character of the gain or loss to the distributee partner shall be determined by the character of the property in which he relinquished his interest.

(3) Distribution of partnership property other than M.S.A. 290.31, Subd. 21 property.—

(i) To the extent that a partner receives a distribution of partnership property (including money) other than M.S.A. 290.31, Subd. 21 property in exchange for any part of his interest in M.S.A. 290.31, Subd. 21 property of the partnership, the distribution shall be treated as a sale or exchange of such properties between the distributee partner and the partnership (as constituted after the distribution).

(ii) At the time of the distribution, the partnership (as constituted after the distribution) realizes gain or loss on the sale or exchange of the property other than M.S.A. 290.31, Subd. 21 property. The amount of the gain to the partnership will be measured by the difference between the adjusted basis to the partnership of the distributed property considered as sold to or exchanged with the partner, and the fair market value of the distributee partner's interest in M.S.A. 290.31, Subd. 21 property which he relinquished in the exchange. The character of the gain or loss to the partnership is determined by the character of the distributed property treated as sold or exchanged by the partnership. In computing the partners' distributive shares of such gain or loss, the gain or loss shall be allocated only to partners other than the distributee and separately taken into account under M.S.A. 290.31, Subd. 2 (1) (f).

(iii) At the time of the distribution, the distributee partner realizes ordinary income or loss on the sale or exchange of M.S.A. 290.31, Subd. 21 property. The amount of the distributee partner's income or loss shall be measured by the difference between his adjusted basis for the M.S.A. 290.31, Subd. 21 property relinquished in the exchange (including any special basis adjustment which he may have), and the fair market value of other property (including money) received by him in exchange for his interest in the M.S.A. 290.31, Subd. 21 property which he has relinquished. The distributee partner's adjusted basis for the M.S.A. 290.31, Subd. 21 property relinquished is the basis such property would have had under M.S.A. 290.31, Subd. 13 (including subsection 5 thereof) if the distributee partner had received such property in a current distribution immediately before the actual distribution which is treated wholly or partly as a sale or exchange under M.S.A. 290.31, Subd. 21 (2).

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(4) **Exceptions.—**

(i) M.S.A. 290.31, Subd. 21 (2) does not apply to the distribution to a partner of property which the distributee partner contributed to the partnership. The distribution of such property is governed by the rules set forth in M.S.A. 290.31, Subds. 12 through 17, relating to distributions by a partnership.

(ii) M.S.A. 290.31, Subd. 21 (2) does not apply to payments made to a retiring partner or to a deceased partner's successor in interest to the extent that, under M.S.A. 290.31, Subd. 17 (1), such payments constituted a distributive share of partnership income or guaranteed payments. Payments to a retiring partner or to a deceased partner's successor in interest for his interest in unrealized receivables of the partnership in excess of their partnership basis, including any special basis adjustment for them to which such partner is entitled, constitute payments under M.S.A. 290.31, Subd. 17 (1) and, therefore, are not subject to M.S.A. 290.31, Subd. 21 (2). However, payments under M.S.A. 290.31, Subd. 17 (2) which are considered as made in exchange for an interest in partnership property are subject to M.S.A. 290.31, Subd. 21 (2) to the extent that they involve an exchange of substantially appreciated inventory items for other property. Thus, payments to a retiring partner or to a deceased partner's successor in interest under M.S.A. 290.31, Subd. 17 must first be divided between payments under M.S.A. 290.31, Subd. 17 (1) and (2). The M.S.A. 290.31, Subd. 17 (2) payments must then be divided, if there is an exchange of substantially appreciated inventory items for other property between the payments treated as a sale or exchange under M.S.A. 290.31, Subd. 21 (2) and payments treated as a distribution under M.S.A. 290.31, Subds. 12 through 17. See subparagraph (1) (iii) of this paragraph, and M.S.A. 290.31, Subd. 17 and Reg. 2031 (17).

(5) **Statement required.** A partnership which distributes M.S.A. 290.31, Subd. 21 property to a partner in exchange for his interest in other partnership property, or which distributes other property in exchange for any part of the partner's interest in M.S.A. 290.31, Subd. 21 property, shall submit with its return for the year of the distribution a statement showing the computation of any income, gain, or loss to the partnership under the provisions of M.S.A. 290.31, Subd. 21 (2) and this paragraph. The distributee partner shall submit with his return a statement showing the computation of any income, gain, or loss to him. Such statement shall contain information similar to that required under paragraph (a) (3) of this regulation.

(c) **Unrealized receivables.—**

(1) The term "unrealized receivables" as used in M.S.A. 290.31, means any rights (contractual or otherwise) to payment for—

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(i) Goods delivered or to be delivered (to the extent that such payment would be treated as received for property other than a capital asset) ; or

(ii) Services rendered or to be rendered, to the extent that income arising from such rights to payment was not previously includible in income under the method of accounting employed by the partnership. Such rights must have arisen under contracts or agreements in existence at the time of sale or distribution, although the partnership may not be able to enforce payment until a later time. For example, the term includes trade accounts receivable of a cash method taxpayer, and rights to payment for work or goods begun but incomplete at the time of the sale or distribution.

(2) The basis for such unrealized receivables shall include all costs or expenses attributable thereto paid or accrued but not previously taken into account under the partnership method of accounting.

(3) In determining the amount of the sale price attributable to unrealized receivables, or their value in a distribution treated as a sale or exchange, any arm's length agreement between the buyer and the seller, or between the partnership and the distributee partner, will generally establish the amount or value. In the absence of such an agreement, full account shall be taken not only of the estimated cost of completing performance of the contract or agreement, but also of the time between the sale or distribution and the time of payment.

(d) **Inventory items which have substantially appreciated in value.—**

(1) **Substantial appreciation.** Partnership inventory items shall be considered to have appreciated substantially in value if, at the time of the sale or distribution, the total fair market value of all the inventory items of the partnership exceeds 120 per cent of the aggregate adjusted basis for such property in the hands of the partnership (without regard to any special basis adjustment of any partner) and, in addition, exceeds 10 per cent of the fair market value of all partnership property other than money. The terms "inventory items which have appreciated substantially in value" or "substantially appreciated inventory items" refer to the aggregate of all partnership inventory items. These terms do not refer to specific partnership inventory items or to specific groups of such items. For example, any distribution of inventory items by a partnership the inventory items of which as a whole has substantially appreciated in value shall be a distribution of substantially appreciated inventory items for the purposes of M.S.A. 290.31, Subd. 21 (2), even though the specific inventory items distributed may not be appreciated in value. Similarly, if the aggregate of partnership inventory items

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are not substantially appreciated in value, a distribution of specific inventory items, the value of which is more than 120 per cent of their adjusted basis, will not constitute a distribution of substantially appreciated inventory items. For the purpose of this paragraph, the "fair market value" of inventory items has the same meaning as "market" value in the regulations under M.S.A. 290.11, relating to general rule for inventories.

(2) **Inventory items.** The term "inventory items" as used in M.S.A. 290.31 includes the following types of property:

(i) Stock in trade of the partnership, or other property of a kind which would properly be included in the inventory of the partnership if on hand at the close of the taxable year, or property held by the partnership primarily for sale to customers in the ordinary course of its trade or business. See M.S.A. 290.16, Subd. 3 (a).

(ii) Any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in M.S.A. 290.16, Subd. 9. Thus, accounts receivable acquired in the ordinary course of business for services or from the sale of stock in trade constitute inventory items (see M.S.A. 290.16, Subd. 3 (c)), as do any unrealized receivables.

(iii) Any other property retained by the partnership which, if held by the partner selling his partnership interest or receiving a distribution described in M.S.A. 290.31, Subd. 21 (2), would be considered property described in subdivisions (i) or (ii) of this subparagraph. Property actually distributed to the partner does not come within the provisions of M.S.A. 290.31, Subd. 21 (4) (b) which read, "and any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in this sentence," and this subdivision.

(e) **M.S.A. 290.31, Subd. 21 property and other property.** For the purposes of this regulation, "M.S.A. 290.31, Subd. 21 property" means unrealized receivables or substantially appreciated inventory items, and "other property" means all property (including money) except M.S.A. 290.31, Subd. 21 property.

(f) **Examples.** Application of the provisions of M.S.A. 290.31, Subd. 21 may be illustrated by the following examples:

Example (1). C buys B's interest in personal service partnership AB for $15,000, when the balance sheet of the firm (reflecting a cash receipts and disbursements method of accounting) is as follows:

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Assets

	Adjusted Basis Per Books	Market Value
Cash	$ 3,000	$ 3,000
Loans receivable	10,000	10,000
Other assets	7,000	7,000
Unrealized receivables	0	12,000
	$20,000	$32,000

Liabilities and Capital

	Per Books	Value
Liabilities	$ 2,000	$ 2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
	$20,000	$32,000

M.S.A. 290.31, Subd. 21 (1) applies to the sale. The total amount realized by B is $16,000, consisting of the cash received, $15,000, plus $1,000, B's share of the partnership liabilities assumed by C. See M.S.A. 290.31, Subd. 22. B's undivided half-interest in the partnership property includes a half-interest in the partnership's unrealized receivables which are worth $12,000. Consequently, $6,000 of the $16,000 realized by B shall be considered received in exchange for B's interest in the partnership attributable to its unrealized receivables. The remaining $10,000 realized by B is in exchange for a capital asset. B's basis for his partnership interest is $10,000 ($9,000, plus $1,000, B's share of partnership liabilities). No portion of this basis is attributable to B's share of the unrealized receivables of the partnership since such property has a zero basis in the hands of the partnership; therefore, B has a basis of zero for the unrealized receivables because the partnership basis for such receivables would have carried over to him under M.S.A. 290.31, Subd. 13 had they been distributed to him. The difference between the zero basis and the $6,000 B realized for the unrealized receivables is ordinary income to him. The entire $10,000 of B's basis is the basis for his interest in partnership property other than unrealized receivables and is applied against the remaining $10,000 ($16,000 minus $6,000) received from the sale of his interest. Therefore, B has no capital gain or loss. (If B's basis for his interest in partnership property, other than unrealized receivables, were $9,000, he would realize capital gain of $1,000. If his basis were $11,000, he would sustain a capital loss of $1,000.)

Example (2). (a) *Facts.* Partnership ABC makes a distribution to partner C in liquidation of his entire one-third interest

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in the partnership. At the time of the distribution, the balance sheet of the partnership, which uses the accrual method of accounting, is as follows:

Assets

	Adjusted Basis Per Books	Market Value
Cash	$15,000	$15,000
Accounts receivable	9,000	9,000
Inventory	21,000	30,000
Depreciable property	42,000	48,000
Land	9,000	9,000
Total	$96,000	$111,000

Liabilities and Capital

	Per Books	Value
Current liabilities	$15,000	$15,000
Mortgage payable	21,000	21,000
Capital:		
A	20,000	25,000
B	20,000	25,000
C	20,000	25,000
Total	$96,000	$111,000

The distribution received by C consists of $10,000 cash and depreciable property with a fair market value of $15,000 and an adjusted basis to the partnership of $15,000.

(b) *Presence of M.S.A. 290.31, Subd. 21 property.* The partnership has no unrealized receivables, but the dual test provided in M.S.A. 290.31, Subd. 21 (4) (a) must be applied to determine whether the inventory items of the partnership, in the aggregate, have appreciated substantially in value. The fair market value of all partnership inventory items, $39,000 (inventory $30,000, and accounts receivable $9,000), exceeds 120 per cent of the $30,000 adjusted basis of such items to the partnership. The fair market value of the inventory items, $39,000, also exceeds 10 per cent of the fair market value of all partnership property other then money (10 per cent of $96,000 or $9,600). Therefore, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* Since C's entire partnership interest is to be liquidated, the provisions of M.S.A. 290.31, Subd. 17 are applicable. No part of the payment, however, is considered as a distributive share or as a guaranteed payment under M.S.A. 290.31, Subd. 17 (1) because the entire payment is made for C's interest in partnership property. Therefore, the entire payment is for an interest in partnership property under M.S.A. 290.31, Subd. 17 (2), and, to the extent applicable, sub-

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ject to the rules of M.S.A. 290.31, Subd. 21. In the distribution, C received his share of cash ($5,000) and $15,000 in depreciable property ($1,000 less than his $16,000 share). In addition, he received other partnership property ($5,000 cash and $12,000 liabilities assumed, treated as money distributed under M.S.A. 290.31, Subd. 22 (2)) in exchange for his interest in accounts receivable ($3,000), inventory ($10,000), land ($3,000), and the balance of his interest in depreciable property ($1,000). M.S.A. 290.31, Subd. 21 (2) applies only to the extent of the exchange of other property for M.S.A. 290.31, Subd. 21 property (i.e., inventory items, which include trade accounts receivable). The M.S.A. 290.31, Subd. 21 property exchanged has a fair market value of $13,000 ($3,000 in accounts receivable and $10,000 in inventory). Thus, $13,000 of the total amount C received is considered as received for the sale of M.S.A. 290.31, Subd. 21 property.

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* C's share of the inventory items is treated as if he received them in a current distribution, and his basis for such items is $10,000 ($7,000 for inventory and $3,000 for accounts receivable) as determined under paragraph (b) (3) (iii) of this regulation. Then C is considered as having sold his share of inventory items to the partnership for $13,000. Thus, on the sale of his share of inventory items, C realizes $3,000 of ordinary income.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* M.S.A. 290.31, Subd. 21 (2) does not apply to the balance of the distribution. Before the distribution, C's basis for his partnership interest was $32,000 ($20,000 plus $12,000, his share of partnership liabilities). See M.S.A. 290.31, Subd. 22 (1). This basis is reduced by $10,000, the basis attributed to the M.S.A. 290.31, Subd. 21 property treated as distributed to C and sold by him to the partnership. Thus, C has a basis of $22,000 for the remainder of his partnership interest. The total distribution to C was $37,000 ($22,000 in cash and liabilities assumed, and $15,000 in depreciable property). Since C received no more than his share of the depreciable property, none of the depreciable property constitutes proceeds of the sale under M.S.A. 290.31, Subd. 21 (2). C did receive more than his share of money. Therefore, the sale proceeds, treated separately in subparagraph (1) of this paragraph of this example, must consist of money and therefore must be deducted from the money distribution. Consequently in liquidation of the balance of C's interest, he received depreciable property and $9,000 in money ($22,000 less $13,000). Therefore, no gain or loss is recognized to C on the distribution. Under M.S.A. 290.31, Subd. 13 (3),

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C's basis for the depreciable property is $13,000 (the remaining basis of his partnership interest, $22,000, reduced by $9,000, the money received in the distribution).

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* The partnership consisting of the remaining members has no ordinary income on the distribution since it did not give up any M.S.A. 290.31, Subd. 21 property in the exchange. Of the $22,000 money distributed (in cash and the assumption of C's share of liabilities), $13,000 was paid to acquire C's interest in inventory ($10,000 fair market value) and in accounts receivable ($3,000). Since under M.S.A. 290.31, Subd. 21 (2) the partnership is treated as buying these properties, it has a new cost basis for the inventory and accounts receivable acquired from C. Its basis for C's share of inventory and accounts receivable is $13,000, the amount which the partnership is considered as having paid C in the exchange. Since the partnership is treated as having distributed C's share of inventory and accounts receivable to him, the partnership must decrease its basis for inventory and accounts receivable ($30,000) by $10,000, the basis of C's share treated as distributed to him, and then increase the basis for inventory and accounts receivable by $13,000 to reflect the purchase prices of the items acquired. Thus, the basis of the partnership inventory is increased from $21,000 to $24,000 in the transaction. (Note that the basis of property acquired in M.S.A. 290.31, Subd. 21 (2) exchange is determined under M.S.A. 290.14 without regard to any elections of the partnership. (See Reg. 2031 (13)-1 (e).) Further, the partnership realizes no capital gain or loss on the portion of the distribution treated as a sale under M.S.A. 290.31, Subd. 21 (2) since, to acquire C's interest in the inventory and accounts receivable, it gave up money and assumed C's share of liabilities.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* In the remainder of the distribution to C which was not in exchange for C's interest in M.S.A. 290.31, Subd. 21 property, C received only other property as follows: $15,000 in depreciable property (with a basis to the partnership of $15,000) and $9,000 in money ($22,000 less $13,000 treated under subparagraph (1) of this paragraph of this example). Since this part of the distribution is not an exchange of M.S.A. 290.31, Subd. 21 property for other property, M.S.A. 290.31, Subd. 21 (2) does not apply. Instead, the provisions which apply are M.S.A. 290.31, Subds. 12 through 17, relating to distributions by a partnership. No gain or loss is recognized to the partnership on the distribution. (See M.S.A. 290.31, Subd. 12.) Further, the partnership makes no adjustment to the basis of remaining depreciable property unless an election under M.S.A. 290.31, Subd.

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24 is in effect. (See M.S.A. 290.31, Subd. 15 (1).) Thus, the basis of the depreciable property before the distribution, $42,000, is reduced by the basis of the depreciable property in the partnership of $27,000. However, if an election under M.S.A. 290.31, Subd. 24 is in effect, the partnership must make the adjustment required under M.S.A. 290.31, Subd. 15 (2) as follows: Since the adjusted basis of the distributed property to the partnership had been $15,000, and is only $13,000 in C's hands (see paragraph (d) (2) of this example), the partnership will increase the basis of the depreciable property remaining in the partnership by $2,000 (the excess of the adjusted basis to the partnership of the distributed depreciable property immediately before the distribution over its basis to the distributee). Whether or not an election under M.S.A. 290.31, Subd. 24 is in effect, the basis for each of the remaining partner's partnership interests will be $38,000 ($20,000 original contribution, plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities each assumed).

(f) *Partnership trial balance.* A trial balance of the AB partnership after the distribution in liquidation of C's entire interest would reflect the results set forth in the schedule below. Column I shows the amounts to be reflected in the records if an election is in effect under M.S.A. 290.31, Subd. 24 with respect to an optional adjustment under M.S.A. 290.31, Subd. 15 (2) to the basis of undistributed partnership property. Column II shows the amounts to be reflected in the records where an election under M.S.A. 290.31, Subd. 24 is not in effect. Note that in Column II, the total bases for the partnership assets do not equal the total of the bases for the partnership interests.

	I M.S.A. 290.31, Subd. 24 Election in Effect		II M.S.A. 290.31, Subd. 24 Election Not in Effect	
	Basis	Fair Market Value	Basis	Fair Market Value
Cash	$ 5,000	$ 5,000	$ 5,000	$ 5,000
Accounts receivable	9,000	9,000	9,000	9,000
Inventory	24,000	30,000	24,000	30,000
Depreciable property	29,000	33,000	27,000	33,000
Land	9,000	9,000	9,000	9,000
	$76,000	$86,000	$74,000	$86,000
Current liabilities	$15,000	$15,000	$15,000	$15,000
Mortgage	21,000	21,000	21,000	21,000
Capital: A	20,000	25,000	20,000	25,000
B	20,000	25,000	20,000	25,000
	$76,000	$86,000	$76,000	$86,000

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Example (3). (a) *Facts.* Assume that the distribution to partner C in example (2) of this paragraph in liquidation of his entire interest in partnership ABC consists of $5,000 in cash and $20,000 worth of partnership inventory with a basis of $14,000.

(b) *Presence of M.S.A. 290.31, Subd. 21 property.* For the same reason as stated in paragraph (b) of that example, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* In the distribution, C received his share of cash ($5,000) and his share of appreciated inventory items ($13,000). In addition, he received appreciated inventory with a fair market value of $7,000 (and with an adjusted basis to the partnership of $4,900) and $12,000 in money (liabilities assumed). C has relinquished his interest in $16,000 of depreciable property and $3,000 of land. Although C relinquished his interest in $3,000 of accounts receivable, such accounts receivable are inventory items and, therefore, that exchange was not an exchange of M.S.A. 290.31, Subd. 21 property for other property. M.S.A. 290.31, Subd. 21 (2) applies only to the extent of the exchange of other property for M.S.A. 290.31, Subd. 21 property (i.e., depreciable property or land for inventory items). Assume that the partners agree that the $7,000 of inventory in excess of C's share was received by him in exchange for $7,000 of depreciable property.

(d) *Distributee partner's tax consequences.* C's tax consequence on the distributions are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* C is treated as if he had received his 7/16ths share of the depreciable property in a current distribution. His basis for that share is $6,125 (42,000/48,000 of $7,000), as determined under paragraph (b) (2) (iii) of this regulation. Then C is considered as having sold his 7/16ths share of depreciable property to the partnership for $7,000, realizing a gain of $875.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* M.S.A. 290.31, Subd. 21 (2) does not apply to the balance of the distribution. Before the distribution, C's basis for his partnership interest was $32,000 ($20,000, plus $12,000, his share of partnership liabilities). See M.S.A. 290.31, Subd. 22 (1). This basis is reduced by $6,125, the basis of property treated as distributed to C and sold by him to the partnership. Thus, C will have a basis of $25,875 for the remainder of his partnership interest. Of the $37,000 total distribution to C, $30,000 ($17,000 in money, including liabilities assumed, and $13,000 in inventory) is not within M.S.A. 290.31, Subd. 21 (2). Under M.S.A. 290.31, Subd. 13 (3), C's basis for the inventory with a fair market value of $13,000 (which had an adjusted basis to the partnership of $9,100) is limited to $8,875, the amount of

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the remaining basis for his partnership interest, $25,875, reduced by $17,000, the money received. Thus, C's total aggregate basis for the inventory received is $15,875 ($7,000 plus $8,875), and not its $14,000 basis in the hands of the partnership.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* The partnership consisting of the remaining members has $2,100 of ordinary income on the sale of the $7,000 of inventory which had a basis to the partnership of $4,900 (21,000/30,000 of $7,000). This $7,000 of inventory was paid to acquire 7/16ths of C's interest in the depreciable property. Since, under M.S.A. 290.31, Subd. 21 (2), the partnership is treated as buying this property from C, it has a new cost basis for such property. Its basis for the depreciable property is $42,875 ($42,000 less $6,125, the basis of the 7/16ths share considered as distributed to C, plus $7,000, the partnership purchase price for this share).

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* In the remainder of the distribution to C which was not a sale or exchange of M.S.A. 290.31, Subd. 21 property for other property, the partnership realizes no gain or loss. See M.S.A. 290.31, Subd. 12. Further, under M.S.A. 290.31, Subd. 15 (1), the partnership makes no adjustment to the basis of the accounts receivable or the 9/16ths interest in depreciable property which C relinquished. However, if an election under M.S.A. 290.31, Subd. 24 is in effect, the partnership must make the adjustment required under M.S.A. 290.31, Subd. 15 (2) since the adjusted basis to the partnership of the inventory distributed had been $9,100, and C's basis for such inventory after distribution is only $8,875. The basis of the inventory remaining in the partnership must be increased by $225. Whether or not an election under M.S.A. 290.31, Subd. 24 is in effect, the basis for each of the remaining partnership interests will be $39,050 ($20,000 original contribution, plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities now assumed, plus $1,050, each partner's share of ordinary income realized by the partnership upon that part of the distribution treated as a sale or exchange).

Example (4). (a) *Facts.* Assume the same facts as in example (3) of this paragraph, except that the partners did not identify the property which C relinquished in exchange for the $7,000 of inventory which he received in excess of his share.

(b) *Presence of M.S.A. 290.31, Subd. 21 property.* For the same reasons state in paragraph (b) of example (2) of this paragraph the partnership inventory items have substantially appreciated in value.

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(c) *The properties exchanged.* The analysis stated in paragraph (c) of example (3) of this paragraph is the same in this example, except that, in the absence of a specific agreement among the partners as to the properties exchanged, C will be presumed to have sold to the partnership a proportionate amount of each property in which he relinquished an interest. Thus, in the absence of an agreement, C has received $7,000 of inventory in exchange for his release of 7/19ths of the depreciable property and 7/19ths of the land. ($7,000, fair market value of property released, over $19,000, the sum of the fair market values of C's interest in the land and C's interest in the depreciable property.)

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* C is treated as if he had received his 7/19ths shares of the depreciable property and land in a current distribution. His basis for those shares is $6,263 (51,000/57,000 of $7,000, their fair market value), as determined under paragraph (b) (2) (iii) of this regulation. Then C is considered as having sold his 7/19ths shares of depreciable property and land to the partnership for $7,000, realizing a gain of $737.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* M.S.A. 290.31, Subd. 21 (2) does not apply to the balance of the distribution. Before the distribution C's basis for his partnership interest was $32,000 ($20,000 plus $12,000, his share of partnership liabilities). See M.S.A. 290.31, Subd. 22 (1). This basis is reduced by $6,263, the bases of C's shares of depreciable property and land treated as distributed to him and sold by him to the partnership. Thus, C will have a basis of $25,737 for the remainder of his partnership interest. Of the total $37,000 distributed to C, $30,000 ($17,000 in money, including liabilities assumed, and $13,000 in inventory) is not within M.S.A. 290.31, Subd. 21 (2). Under M.S.A. 290.31, Subd. 13 (3), C's basis for the inventory (with a fair market value of $13,000 and an adjusted basis to the partnership of $9,100) is limited to $8,737, the amount of the remaining basis for his partnership interest ($25,737 less $17,000, money received). Thus, C's total aggregate basis for the inventory he received is $15,737 ($7,000 plus $8,737), and not the $14,000 basis it had in the hands of the partnership.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* The partnership consisting of the remaining members has $2,100 of ordinary income on the sale of $7,000 of inventory which had a basis to the partnership of $4,900 (21,000/30,000

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of $7,000). This $7,000 of inventory was paid to acquire 7/19ths of C's interest in the depreciable property and land. Since, under M.S.A. 290.31, Subd. 21 (2), the partnership is treated as buying this property from C, it has a new cost basis for such property. The bases of the depreciable property and land would be $42,737 and $9,000, respectively. The basis for the depreciable property is computed as follows: The common partnership basis of $42,000 is reduced by the $5,158 basis (42,000/48,000 of $5,895) for C's 7/19ths interest constructively distributed, and increased by $5,895 (16,000/19,000 of $7,000), the part of the purchase price allocated to the depreciable property. The basis of the land would be computed in the same way. The $9,000 original partnership basis is reduced by $1,105 basis (9,000/9,000 of $1,105) of the land constructively distributed to C, and increased by $1,105 (3,000/19,000 of $7,000), the portion of the purchase price allocated to the land.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* In the remainder of the distribution to C which was not a sale or exchange of M.S.A. 290.31, Subd. 21 property for other property, the partnership realizes no gain or loss. See M.S.A. 290.31, Subd. 12. Further, under M.S.A. 290.31, Subd. 15 (1), the partnership makes no adjustment to the basis of the accounts receivable or the 12/19ths interests in depreciable property and land which C relinquished. However, if an election under M.S.A. 290.31, Subd. 24 is in effect, the partnership must make the adjustment required under M.S.A. 290.31, Subd. 15 (2) since the adjusted basis to the partnership of the inventory distributed had been $9,100 and C's basis for such inventory after the distribution is only $8,737. The basis of the inventory remaining in the partnership must be increased by the difference of $363. Whether or not an election under M.S.A. 290.31, Subd. 24 is in effect, the basis for each of the remaining partnership interests will be $39,050 ($20,000 original contribution plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities assumed, plus $1,050, each partner's share of ordinary income realized by the partnership upon the part of the distribution treated as a sale or exchange).

Example (5). (a) *Facts.* Assume that partner C in example (2) of this paragraph agrees to reduce his interest in capital and profits from ⅓ to ⅕ for a current distribution consisting of $5,000 in cash, and $7,500 of accounts receivable with a basis to the partnership of $7,500. At the same time, the total liabilities of the partnership are not reduced. Therefore, after the distribution, C's share of the partnership liabilities has been reduced by $4,800 from $12,000 (⅓ of $36,000) to $7,200 (⅕ of $36,000).

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(b) *Presence of M.S.A. 290.31, Subd. 21 property.* For the same reasons as stated in paragraph (b) of example (2) of this paragraph, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* C's interest in the fair market value of the partnership properties before and after the distribution can be illustrated by the following table:

	C's interest		C received		
	Fair Market Value				
Item	⅛ Before	⅛ After	Distribution of share	In Excess of share	C Relinquished
Cash	$ 5,000	$ 2,000	$ 3,000	$ 2,000	.....
(Liabilities assumed)	(12,000)	(7,200)	.....	4,800	.....
Inventory Items					
Accounts Receivable	3,000	300	2,700	4,800	.....
Inventory	10,000	6,000	.....	.....	4,000
Depreciable Property	16,000	9,600	.....	.....	6,400
Land	3,000	1,800	.....	.....	1,200
Total	$25,000	$12,500	$ 5,700	$11,600	$11,600

Although C relinquished his interest in $4,000 of inventory and received $4,800 of accounts receivable, both items constitute M.S.A. 290.31, Subd. 21 property and C has received only $800 of accounts receivable for $800 worth of depreciable property or for an $800 undivided interest in land. In the absence of an agreement identifying the properties exchanged, it is presumed C received $800 for proportionate shares of his interests in both depreciable property and land. To the extent that inventory was exchanged for accounts receivable, or to the extent cash was distributed for the release of C's interest in the balance of the depreciable property and land, the transaction does not fall within M.S.A. 290.31, Subd. 21 (2) and is a current distribution under M.S.A. 290.31, Subd. 13 (1) and (2). Thus, the remaining $6,700 of accounts receivable are received in a current distribution.

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* Assuming that the partners paid $800 worth of accounts receivable for $800 worth of depreciable property, C is treated as if he received the depreciable property in a current distribution, and his basis for the $800 worth of depreciable property is $700 (42,000/48,000 of $800, its fair market value), as determined under paragraph (b) (2) (iii) of this regulation. Then C is considered as having sold his $800 share of depreciable prop-

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erty to the partnership for $800. On the sale of the depreciable property, C realizes a gain of $100. If, on the other hand, the partners had agreed that C exchanged an $800 interest in the land for $800 worth of accounts receivable, C would realize no gain or loss, because under paragraph (b) (2) (iii) of this regulation his basis for the land sold would be $800. In the absense of an agreement, the basis for the depreciable property and land (which C is considered as having received in a current distribution and then sold back to the partnership) would be $716 (51,000/57,000 of $800). In that case, on the sale of the balance of the $800 share of depreciable property and land, C would realize $84 of gain ($800 less $716).

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* M.S.A. 290.31, Subd. 21 (2) does not apply to the balance of the distribution. Under M.S.A. 290.31, Subd. 12, C does not realize either gain or loss on the balance of the distribution. The adjustments to the basis of C's interest are illustrated in the following table:

	If accounts receivable received for depreciable property	If accounts receivable received for land	If there is no agreement
Original basis for C's interest	$32,000	$32,000	$32,000
Less basis of property distributed prior to M.S.A. 290.31, Subd. 21 (2) sale or exchange	— 700	— 800	— 716
	31,300	31,200	31,284
Less money received in distribution	—9,800	—9,800	—9,800
	21,500	21,400	21,484
Less basis of property received in a current distribution under M.S.A. 290.31, Subd. 13	—6,700	—6,700	—6,700
Resulting basis for C's interest	$14,800	$14,700	$14,784

C's basis for the $7,500 worth of accounts receivable which he received in the distribution will be $7,500, composed of $800 for the portion purchased in the M.S.A. 290.31, Subd. 21 (2) exchange, plus $6,700, the basis carried over under M.S.A. 290.31, Subd. 13 (1) for the portion received in the current distribution.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The M.S.A. 290.31, Subd. 21 (2) sale or exchange.* The partnership realizes no gain or loss in the M.S.A.

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290.31, Subd. 21 sale or exchange because it had a basis of $800 for the accounts receivable for which it received $800 worth of other property. If the partnership agreed to purchase $800 worth of depreciable property, the partnership basis of depreciable property becomes $42,100 ($42,000 less $700 basis of property constructively distributed to C, plus $800, price of property purchased). If the partnership purchased land with the accounts receivable, there would be no change in the basis of the land to the partnership because the basis of land distributed was equal to its purchase price. If there were no agreement, the basis of the depreciable property and land would be $51,084 (depreciable property, $42,084 and land, $9,000). The basis for the depreciable property is computed as follows: The common partnership basis of $42,000 is reduced by the $590 basis (42,000/48,000 of $674) for C's $674 interest constructively distributed, and increased by $674 (6,400/7,600 of $800), the part of the purchase price allocated to the depreciable property. The basis of the land would be computed in the same way. The $9,000 original partnership basis is reduced by $126 basis (9,000/9,000 of $126) of the land constructively distributed to C, and increased by $126 (1,200/-7,600 of $800), the portion of the purchase price allocated to the land.

(2) *The part of the distribution not under M.S.A. 290.31, Subd. 21 (2).* The partnership will realize no gain or loss in the balance of the distribution under M.S.A. 290.31, Subd. 12. Since the property in C's hands after the distribution will have the same basis it had in the partnership, the basis of partnership property remaining in the partnership after the distribution will not be adjusted (whether or not an election under M.S.A. 290.31, Subd. 24 is in effect).

2031 (22) TREATMENT OF CERTAIN LIABILITIES.

(a) **Increase in partner's liabilities.—**

(1) Where the liabilities of a partnership are increased, and each partner's share of such liabilities is thereby increased, the amount of each partner's increase shall be treated as a contribution of money by that partner to the partnership. For example, partnership AB borrows $1,000. If A and B are equal partners, the basis of the partnership interest of each is increased by $500 since each is considered under M.S.A. 290.31, Subd. 22 (1) to have contributed that amount of money to the partnership.

(2) Any increase in a partner's individual liabilities because of the assumption by him of partnership liabilities shall also be considered as a contribution of money by him to the partnership. For example, equal partnership AB owns real property with an adjusted basis to the partnership of $1,000, a fair market value of $800, and which is subject to a mortgage of $400 which

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the partnership has not assumed. The mortgage is considered as a liability of the partnership under M.S.A. 290.31, Subd. 22 (3). Since A and B each share one-half thereof, under M.S.A. 290.31, Subd. 22 (1) the liability of each has been increased $200. Under M.S.A. 290.31, Subd. 10 such $200 increase is reflected in the basis of each partner for his interest. The real property is distributed by the partnership to A. Under the provisions of M.S.A. 290.31, Subd. 14 (2), there is a net decrease of $800 in A's basis for his partnership interest. This amount is computed as follows: The basis of A's partnership interest is decreased in the distribution by $1,000 (the partnership basis for the distributed property) and further decreased under M.S.A. 290.31, Subd. 22 (2) by $200 (the decrease in A's share of partnership liabilities) and increased under M.S.A. 290.31, Subd. 22 (1) by $400 (the increase in A's individual liability by reason of M.S.A. 290.31, Subd. 22 (3)). Conversely, the basis of B's partnership interest is decreased by $200 since the distribution of the real property to A resulted in a decrease in B's share of the partnership liability under M.S.A. 290.31, Subd. 22 (2).

(b) **Decrease in partner's liabilities.—**

(1) Where the liabilities of a partnership are decreased, and each partner's share of such liabilities is thereby decreased, the amount of the decrease shall be treated as a distribution of money to the partner by the partnership. For example, partnership AB, in which A and B are equal partners, repays an obligation of $10,000. The repayment reduced each partner's share of partnership liabilities by $5,000 and is considered a distribution of money which reduces the basis of each partner's interest in the partnership by that amount. For the effect of a discharge of indebtedness on the basis of partnership property, see M.S.A. 290.09, Subd. 12.

(2) Where a partnership assumes the separate liabilities of a partner or a liability to which property owned by such partner is subject (see paragraph (c) of this regulation), the amount of the decrease in such partner's liabilities is treated as a distribution of money by the partnership to such partner. For example, partner A contributed property with a basis of $1,000 to partnership ABC in exchange for a one-third interest in the partnership. The property is subject to a mortgage of $150. (It is immaterial whether the mortgage is assumed by the partnership. See M.S.A. 290.31, Subd. 22 (3).) The basis of A's partnership interest is $900, computed as follows: $1,000, A's basis for the contributed property, reduced by $100, two-thirds of A's original liability of $150 now attributable to partners B and C and reflected in their bases under the provisions of paragraph (a) of this regulation.

(c) **Liability to which property is subject.** Where property subject to a liability is contributed by a partner to a partnership,

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or distributed by a partnership to a partner, the amount of the liability, to an extent not exceeding the fair market value of the property at the time of the contribution or distribution, shall be considered as a liability assumed by the transferee. For example, A contributes property with a basis to him of $1,000 to equal partnership AB. The property is subject to a mortgage of $2,500 and its value exceeds $2,500. Under paragraph (b) of this regulation, A will be treated as receiving a distribution in money of $1,250, one-half of the liability of $2,500 assumed by the partnership. Since the basis of A's partnership interest is $1,000 (the basis of the property contributed by him), the distribution to him of $1,250 results in his realizing a capital gain of $250 under M.S.A. 290.31, Subd. 12. A's basis for his partnership interest is zero. Although as a partner A has a $1,250 share of the $2,500 partnership liability, this $1,250 is not added to the basis of A's partnership interest since it does not represent an increase in liabilities as to him.

(d) **Sale or exchange of a partnership interest.** Where there is a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships. For example, if a partner sells his interest in a partnership for $750 cash and at the same time transfers to the purchaser his share of partnership liabilities amounting to $250, the amount realized by the seller on the transaction is $1,000.

(e) **Partner's share of partnership liabilities.** A partner's share of partnership liabilities shall be determined in accordance with his ratio for sharing losses under the partnership agreement. In the case of a limited partnership, a limited partner's share of partnership liabilities shall not exceed the difference between his actual contribution credited to him by the partnership and the total contribution which he is obligated to make under the limited partnership agreement. However, where none of the partners have any personal liability with respect to a partnership liability (as in the case of a mortgage on real estate acquired by the partnership without the assumption by the partnership or any of the partners of any liability on the mortgage), then all partners, including limited partners, shall be considered as sharing such liability under M.S.A. 290.31, Subd. 22 (3), in the same proportion as they share the profits. The provisions of this paragraph may be illustrated by the following example:

Example. G is a general partner and L is a limited partner in partnership GL. Each makes equal contributions of $20,000 cash to the partnership upon its formation. Under the terms of the partnership agreement, they are to share profits equally but L's liabilities are limited to the extent of his contribution. Subsequently, the partnership pays $10,000 for real property which is subject to a mortgage of $5,000. Neither the partner-

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ship nor any of the partners assume any liability on the mortgage. The basis of such property to the partnership is $15,000. The basis of G and L for their partnership interests is increased by $2,500 each, since each partner's share of the partnership liability (the $5,000 mortgage) has increased by that amount. However, if the partnership had assumed the mortgage so that G had become personally liable thereunder, G's basis for his interest would have been increased by $5,000 and L's basis would remain unchanged.

(f) **Limitation.** In determining the amount of liabilities for the purposes of M.S.A. 290.31, Subd. 22 and this regulation, the amount of an indebtedness is to be taken into account only once, even though a partner (in addition to his liability for such indebtedness as a partner) may be separately liable therefor in a capacity other than as a partner.

2031 (23) PARTNER RECEIVING INCOME IN RESPECT OF DECEDENT.

(a) **Income in respect of a decedent under M.S.A. 290.31, Subd. 17 (1).** All payments coming within the provisions of M.S.A. 290.31, Subd. 17 (1) made by a partnership to the estate or other successor in interest of a deceased partner are considered income in respect of the decedent under M.S.A. 290.077. The estate or other successor in interest of a deceased partner shall be considered to have received income in respect of a decedent to the extent that amounts are paid by a third person in exchange for rights to future payments from the partnership under M.S.A. 290.31, Subd. 17 (1). When a partner who is receiving payments under M.S.A. 290.31, Subd. 17 (1) dies, M.S.A. 290.31, Subd. 23 applies to any remaining payments under M.S.A. 290.31, Subd. 17 (1) made to his estate or other successor in interest.

(b) **Other income in respect of a decedent.** When a partner dies, the entire portion of the distributive share which is attributable to the period ending with the date of his death and which is taxable to his estate or other successor constitutes income in respect of a decedent under M.S.A. 290.077. This rule applies even though that part of the distributive share for the period before death which the decedent withdrew is not included in the value of the decedent's partnership interest for estate tax purposes. Reg. 2031 (6) (c) (3).

(c) **Example.** The provisions of this regulation may be illustrated by the following example:

Example. A and the decedent B were equal partners in a business having assets (other than money) worth $40,000 with an adjusted basis of $10,000. Certain partnership business was well advanced towards completion before B's death and, after

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B's death but before the end of the partnership year, payment of $10,000 was made to the partnership for such work. The partnership agreement provided that, upon the death of one of the partners, all partnership property, including unfinished work, would pass to the surviving partner, and that the surviving partner would pay the estate of the decedent the undrawn balance of his share of the partnership earnings to the date of death, plus $10,000 in each of the three years after death. B's share of earnings to the date of his death was $4,000, of which he had withdrawn $3,000. B's distributive share of partnership income of $4,000 to the date of his death is income in respect of a decedent (although only the $1,000 undrawn at B's death will be reflected in the value of B's partnership interest on B's estate tax return). Assume that the value of B's interest in partnership property at date of his death was $22,000, composed of the following items: B's one-half share of the assets of $40,000, plus $2,000, B's interest in partnership cash. It should be noted that B's $1,000 undrawn share of earnings to the date of his death is not a separate item but will be paid from partnership assets. Under the partnership agreement, A is to pay B's estate a total of $31,000. The difference of $9,000 between the amount to be paid by A ($31,000) and the value of B's interest in partnership property ($22,000) comes within M.S.A. 290.31, Subd. 17 (1) and, thus, also constitutes income in respect of a decedent. (However, the $17,000 difference between the $5,000 basis for B's share of the partnership property and its $22,000 value at the date of his death does not constitute income in respect of a decedent.) If, before the close of the partnership taxable year, A pays B's estate $11,000, of which they agree to allocate $3,000 as the payment under M.S.A. 290.31, Subd. 17 (1), B's estate will include $7,000 in its gross income (B's $4,000 distributive share plus $3,000 payment under M.S.A. 290.31, Subd. 17 (1)).

2031 (24) TIME AND MANNER OF MAKING ELECTION TO ADJUST BASIS OF PARTNERSHIP PROPERTY.

(a) **In general.** A partnership may adjust the basis of partnership property under M.S.A. 290.31, Subds. 15 (2) and 20 (2) if it files an election in accordance with the rules set forth in paragraph (b) of this regulation. An election may not be filed to make the adjustments provided in either Subdivision 15 (2) or 20 (2) alone, but such an election must apply to both subdivisions. An election made under the provisions of this regulation shall apply to all property distributions and transfers of partnership interests taking place in the partnership taxable year for which the election is made and in all subsequent partnership taxable years unless the election is revoked pursuant to paragraph (c) of this regulation.

(b) **Method of making election.** An election under this regulation to adjust the basis of partnership property under M.S.A.

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290.31, Subds. 15 (2) and 20 (2) shall be made in a written statement filed with the partnership return for the first taxable year to which the election applies (or within 90 days after the promulgation of the regulations under M.S.A. 290.31, Subd. 24). The statement shall (1) set forth the name and address of the partnership making the election, (2) be signed by any one of the partners, and (3) contain a declaration that the partnership elects to apply the provisions of M.S.A. 290.31, Subds. 15 (2) and 20 (2).

(c) **Revocation of election.** A partnership having an election in effect under this regulation may revoke such election with the approval of the Commissioner. A partnership which wishes to revoke such an election shall file with the Commissioner an application setting forth the grounds on which the revocation is desired. The application shall be filed not later than 30 days after the close of the partnership taxable year with respect to which revocation is intended to take effect and shall be signed by any one of the partners. Examples of situations which may be considered sufficient reason for approving an application for revocation include a change in the nature of the partnership business, a substantial increase in the assets of the partnership, a change in the character of partnership assets, or an increased frequency of retirements or shifts of partnership interests, so that an increased administrative burden would result to the partnership from the election. However, no application for revocation of an election shall be approved when the purpose of the revocation is primarily to avoid stepping down the basis of partnership assets upon a transfer or distribution.

2031 (25) RULES FOR ALLOCATION OF BASIS.

(a) **General rule.—**

(1) (i) A partnership which has elected under M.S.A. 290.31, Subd. 24 must adjust the basis of partnership property under the provisions of M.S.A. 290.31, Subd. 15 (2) (relating to the optional adjustment to the basis of undistributed partnership property) and M.S.A. 290.31, Subd. 20 (2) (relating to the optional adjustment to the basis of partnership property where a partnership interest is transferred). The amount of the increase or decrease (as determined in those subdivisions) in the adjusted basis of the partnership property shall first be divided under paragraph (b) of this regulation, between the two classes of property described in M.S.A. 290.31, Subd. 25 (2). Then, the portion of the increase or decrease allocated to each class shall be further allocated to the bases of the properties within the class in a manner which will reduce the difference between the fair market value and the adjusted basis of partnership properties. In the alternative, any increase or decrease may be allocated in any other manner approved by the Commissioner under subparagraph (2) of this paragraph.

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(ii) If there is an increase in basis to be allocated to partnership assets, such increase must be allocated only to assets whose values exceed their bases and in proportion to the difference between the value and basis of each. No increase shall be made to the basis of any asset the adjusted basis of which equals or exceeds its fair market value.

(iii) If there is a decrease in basis to be allocated to partnership assets, such decrease must be allocated to assets whose bases exceed their value and in proportion to the difference between the basis and value of each. No decrease shall be made to the basis of any asset, the fair market value of which equals or exceeds its adjusted basis.

(iv) The application of the rules with respect to the allocation of an adjustment in basis under subdivisions (ii) and (iii) of this subparagraph requires that a portion of such adjustment be allocated to partnership good will, to the extent that good will exists and is reflected in the value of the property distributed, the price at which the partnership interest is sold, or the basis of the partnership interest determined under M.S.A. 290.14 (4), in accordance with the difference between such value of the good will and its adjusted basis at the time of the transaction.

(2) If a partnership (or a partner electing under M.S.A. 290.31, Subd. 13 (5)) desires to adjust the basis of assets under M.S.A. 290.31, Subd. 15 (2) or Subd. 20 (2) in a manner other than that prescribed in subparagraph (1) of this paragraph, it must file an application for permission to use such method with the Commissioner no later than 30 days after the close of the partnership taxable year in which the proposed adjustment is to be made. The application must describe the proposed adjustments in detail and set forth the reasons for the desired use of the other method. Under M.S.A. 290.31, Subd. 25 (1) (b), the Commissioner may permit the partnership to increase the bases of some partnership properties and decrease the bases of other partnership properties under M.S.A. 290.31, Subd. 15 (2) or Subd. 20 (2). Each increase or decrease to the basis of an asset must reduce or eliminate the difference between such basis and the value of the asset. The net amount of all such adjustments must equal the amount of the adjustment under M.S.A. 290.31, Subd. 15 (2) or Subd. 20 (2). Adjustments that both increase and decrease the basis of partnership assets will be permitted by the Commissioner only upon a satisfactory showing of the values for partnership assets used by the parties to determine the price at which a partnership interest was sold, the value of the decendent's partnership interest at date of death, or the amount of a distribution.

(b) **Special rules.** For the purposes of applying M.S.A. 290.31, Subd. 25, all partnership property shall be classified into

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two categories: capital assets and property described in M.S.A. 290.16, Subd. 9 (1) (certain property used in the trade or business), or any other property of the partnership.

(1) **Distributions.—**

(i) Where there is a distribution of partnership property resulting in an adjustment to the basis of undistributed partnership property under the portion of M.S.A. 290.31, Subd. 15 (2) which reads:

> "(2) In the case of a distribution of property to a partner, a partnership, with respect to which the election provided in subdivision 24 is in effect, shall
>
> (a) increase the adjusted basis of partnership property by *** in the case of distributed property to which subdivision 13 (2) or (3) applies, the excess of the adjusted basis of the distributed property to the partnership immediately before the distribution (as adjusted by subdivision 13 (5)) over the basis of the distributed property to the distributee, as determined under subdivision 13, or
>
> (b) decrease the adjusted basis of partnership property by *** in the case of distributed property to which subdivision 13 (3) applies, the excess of the basis of the distributed property to the distributee, as determined under subdivision 13, over the adjusted basis of the distributed property to the partnership immediately before such distribution (as adjusted by subdivision 13 (5))."

such adjustment must be allocated to remaining partnership property of a character similar to that of the distributed property with respect to which the adjustment arose. Thus, when the partnership adjusted basis of distributed capital assets and M.S.A. 290.16, Subd. 9 (1) property immediately prior to distribution exceeds the basis of such property to the distributee partner (as determined under M.S.A. 290.31, Subd. 13), the basis of the undistributed capital assets and M.S.A. 290.16, Subd. 9 (1) property remaining in the partnership shall be increased by an amount equal to such excess. Conversely, when the basis to the distributee partner (as determined under M.S.A. 290.31, Subd. 13) of distributed capital assets and M.S.A. 290.31, Subd. 9 (1) property exceeds the partnership adjusted basis of such property, immediately prior to the distribution, the basis of the undistributed capital assets and M.S.A. 290.16, Subd. 9 (1) property remaining in the partnership shall be decreased by an amount equal to such excess. Similarly, where there is a distribution of partnership property other than capital assets and M.S.A. 290.16, Subd. 9 (1) property, and the basis of such other property to the distributee partner (as determined under M.S.A.

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290.31, Subd. 13) is not the same as the partnership adjusted basis of such property immediately prior to distribution, the adjustment shall be made only to undistributed property of the same category remaining in the partnership.

(ii) Where there is a distribution resulting in an adjustment under the portion of M.S.A. 290.31, Subd. 15 (2) which reads:

> "(2) In the case of a distribution of property to a partner, a partnership, with respect to which the election provided in subdivision 24 is in effect, shall
>
> (a) increase the adjusted basis of partnership property by the amount of any gain recognized to the distributee partner with respect to such distribution under subdivision 12 (1), and ***
>
> (b) decrease the adjusted basis of partnership property by the amount of any loss recognized to the distributee partner with respect to such distribution under subdivision 12 (2), and ***"

to the basis of undistributed partnership property, such adjustment must be allocated only to capital assets or M.S.A. 290.16, Subd. 9 (1) property.

(2) **Transfers.** Where there is a basis adjustment under M.S.A. 290.31, Subd. 20 (2) arising from a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, the amount of the adjustment shall be allocated between the two classes of property described in M.S.A. 290.31, Subd. 25 (2) and then the amount allocated to each class shall be further allocated under the rules of paragraph (a) (1) of this regulation. Thus, to the extent that an amount paid by a purchaser of a partnership interest (or the basis of the partnership interest to the estate or other successor in interest of a deceased partner) is attributable to the value of capital assets and M.S.A. 290.16, Subd. 9 (1) property, any difference between the amount so attributable and the transferee partner's share of the partnership basis of such property shall constitute a special basis adjustment with respect to partnership capital assets and M.S.A. 290.16, Subd. 9 (1) property. Similarly, any such difference attributable to any other property of the partnership shall constitute a special basis adjustment with respect to such property.

(3) **Limitation on decrease of basis.** Where a decrease in the basis of partnership assets is required under M.S.A. 290.31, Subd. 15 (2) (b) and the amount of the decrease exceeds the adjusted basis to the partnership of property of the required character, the basis of such property shall be reduced to zero (but not below zero), and the balance of the decrease in basis shall be made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

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(4) **Carryover of adjustment.** Where, in the case of a distribution, an increase or decrease required under paragraph (a) of this regulation in the basis of undistributed partnership property cannot be made because the partnership owns no property of the character required to be adjusted, or because the adjustment has been limited under subparagraph (3) of this paragraph, the adjustment shall be made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(c) **Examples.** The provisions of this regulation may be illustrated by the following examples:

Example (1). Assume that partnership ABC has three assets: X, a capital asset with an adjusted basis of $1,000 and a value of $1,500; Y, a depreciable asset with an adjusted basis of $1,000 and a value of $900; and Z, inventory items with an adjusted basis of $700 and a value of $600. A sells his interest to D (when an election under M.S.A. 290.31, Subd. 24 is in effect) for $1,000 (⅓ of $3,000, the total value of partnership assets). D's share of the adjusted basis of partnership property is $900 (⅓ of $2,700). Therefore, under M.S.A. 290.31, Subd. 20 (2), D has a special basis adjustment of $100 ($1,000 minus $900). This adjustment must be allocated entirely to property X, since such allocation will have the effect of reducing the difference between the value and basis of such asset. Therefore, D has a special basis adjustment of $100 with respect to property X, which now has a special basis to him of $1,100. No part of the adjustment is made to depreciable property Y or inventory items Z, since any such adjustment would increase the difference between the basis and value of each such asset.

Example (2). Assume the same facts as in example (1) of this paragraph except that capital asset X has a value of $1,500, depreciable property Y has a value of $1,100, and inventory items Z have a value of only $400. Therefore, under M.S.A. 290.31, Subd. 20 (2), D has a special basis adjustment of $100, the excess of D's basis for his interest in the partnership ($1,000) over his share of the adjusted basis of partnership property ($900). This $100 adjustment must be allocated entirely to capital asset X and depreciable property Y in proportion to the difference between the value and basis of each since such allocation has the effect of reducing the difference between the value and basis of each such asset. Therefore, D has a special basis adjustment of $83 (500/600 of $100) with respect to capital asset X, which now has a special basis to him of $1,083, and of $17 (100/600 of $100) with respect to depreciable property Y, which now has a special basis to him of $1,017. No part of the adjustment is made to inventory items Z, since any such adjustment would increase the difference between the basis of such asset and its value.

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Example (3). Assume that partnership EFG has three assets: X, a capital asset with an adjusted basis of $1,000 and a value of $1,500; Y, a depreciable asset with an adjusted basis of $1,000 and a value of $700; and Z, inventory items with an adjusted basis of $700 and a value of $800. E sells his interest to H (when an election under M.S.A. 290.31, Subd. 24 is in effect) for $1,000 (⅓ of $3,000, the total value of the partnership assets). H's share of the adjusted basis of partnership property is $900 (⅓ of $2,700). Therefore, H has a special basis adjustment of $100 ($1,000 minus $900) under M.S.A. 290.31, Subd. 20 (2). Since, of the total $300 difference between the value and the adjusted basis of all partnership property, $200 ($500, appreciation in value of X, minus $300, depreciation in value of Y) is attributable to the class of capital assets and depreciable property, and $100 (appreciation in value of inventory items Z) to the class of other property, H's special basis adjustment of $100 must be allocated ⅔ to capital assets and depreciable property and ⅓ to other property (inventory). The $67 increase (⅔ of $100) to be allocated to capital assets and depreciable property must further be allocated so as to reduce the difference between the value and basis of such assets. This can be done only by allocating the entire $67 increase to capital asset X (the basis of which is less than its value), and no part of the increase to depreciable property Y (the basis of which exceeds its value). Therefore, H has a special basis adjustment of $67 for capital asset X, which now has a special basis to him of $1,067; he has no special basis adjustment for depreciable property Y. H also has a special basis adjustment of $33 (⅓ of $100) for inventory items Z, the special basis of which is now $733.

2031 (26) APPLICATION, LIMITATION OF SECTION; DEFINITIONS.

(a) Exclusion of certain partnerships from provisions of M.S.A. 290.31.—

(1) **In general.** Under the conditions set forth in this paragraph, an unincorporated organization described in subdivision (2) or (3) of this subparagraph may be excluded from the application of all or a part of the provisions of M.S.A. 290.31. Such organization must be availed of for investment purposes only and not for the active conduct of a business, or for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted. The members of such organization must be able to compute their income without the necessity of computing partnership taxable net income. Any syndicate, group, pool, or joint venture which is classifiable under M.S.A. 290.01, Subd. 4 as an association, or any group operating under an agreement which creates an organization classifiable as an association, does not fall within these provisions.

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(2) **Investing partnership.** Where the participants in the joint purchase, retention, sale, or exchange of investment property—

(i) Own the property as coowners.

(ii) Reserve the right separately to take or dispose of their shares of any property acquired or retained, and

(iii) Do not actively conduct business or irrevocably authorize some person or persons acting in a representative capacity to purchase, sell, or exchange such investment property, although each separate participant may delegate authority to purchase, sell, or exchange his share of any such investment property for the time being for his account, but not for a period of more than a year, then

such group may be excluded from the application of the provisions of M.S.A. 290.31 under the rules set forth in subdivision (4) of this subparagraph.

(3) **Operating agreements.** Where the participants in the joint production, extraction, or use of property—

(i) Own the property as coowners, either in fee or under lease or other form of contract granting exclusive operating rights, and

(ii) Reserve the right separately to take in kind or dispose of their shares of any property produced, extracted, or used, and

(iii) Do not jointly sell services or the property produced or extracted, although each separate participant may delegate authority to sell his share of the property produced or extracted for the time being for his account, but not for a period of time in excess of the minimum needs of the industry, and in no event for more than one year, then

such group may be excluded from the application of the provisions of M.S.A. 290.31 under the rules set forth in subdivision (4) of this subparagraph. However, the preceding sentence does not apply to any unincorporated organization one of whose principal purposes is cycling, manufacturing, or processing for persons who are not members of the organization.

(4) **Method of election.—**

(i) **Complete exclusions from M.S.A. 290.31.** Any unincorporated organization described in (1) and (2) or (3) of this subparagraph which wishes to be excluded from all of M.S.A. 290.31 must make the election provided in M.S.A. 290.31, Subd. 26 (1) in a statement attached to a properly executed partnership return, Form I-3, which shall contain the information required in this subdivision. Such return shall be filed with the Commissioner. For the first year with respect to which such unincorpo-

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rated organization wishes to be excluded from M.S.A. 290.31, its partnership return shall contain, in lieu of the information required by Form I-3 and by the instructions relating thereto, only the name or other identification and the address of the organization. The statement attached to the return shall include the names and addresses of all the members of the organization; a statement that the organization qualifies under subdivisions (1) and either (2) or (3) of this subparagraph, a statement that all of the members of the organization elect that it be excluded from all of M.S.A. 290.31; and a statement indicating where a copy of the agreement under which the organization operates is available (or, if the agreement is oral, from whom the provisions of the agreement may be obtained). Unless within 90 days after the formation of the organization (or after the promulgation of the regulations under M.S.A. 290.31, whichever is later) any member of the organization notifies the Commissioner that the member desires M.S.A. 290.31 to apply to such organization, and also advises the Commissioner that he has so notified all other members of the organization by registered or certified mail, the election to be excluded will be effective. Such election is irrevocable as long as the organization remains qualified under subdivisions (1) and either (2) or (3) of this subparagraph, or unless approval of revocation of the election is secured from the Commissioner. Application for permission to revoke the election must be submitted to the Commissioner no later than 30 days after the beginning of the first taxable year to which the revocation is to apply. An unincorporated organization need not file an election to be excluded under M.S.A. 290.31, Subd. 26 for the first year of its existence but may do so at the time of filing the return for any taxable year for which exclusion from M.S.A. 290.31 is desired. Such unincorporated organization shall file a partnership return for the first taxable year in which the participants by a formal agreement undertake to engage in joint operations, or in the absence of a formal agreement for the first taxable year in which the participants with respect to the joint use of property jointly make or incur any expenditures treated as deductions for Minnesota income tax purposes, whether or not electing to be excluded from the provisions of M.S.A. 290.31. Where no annual accounting period has been adopted by such unincorporated organization, its taxable year shall be a calendar year in accordance with M.S.A. 290.07, Subd. 1.

(ii) **Partial exclusion from M.S.A. 290.31.** An unincorporated organization which wishes to be excluded from only certain subdivisions of M.S.A. 290.31 must submit to the Commissioner, no later than 90 days after the beginning of the first taxable year for which partial exclusion is desired, a request for permission to be excluded from certain provisions of M.S.A. 290.31. The request shall set forth the subdivisions of M.S.A. 290.31 from which exclusion is sought and shall state that such

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organization qualifies under subdivisions (1) and either (2) or (3) of Reg. 2031 (26) (a), and that the members of the organization elect to be excluded to the extent indicated. Such exclusion shall be effective only upon approval of the election by the Commissioner and subject to the conditions he may impose.

(5) **Information to be filed by organizations excluded under M.S.A. 290.31, Subd. 26.—**

(i) An organization which elects under subdivision (4) (i) of this subparagraph to be excluded from all of M.S.A. 290.31 shall file with the Commissioner the following:

(A) For the first taxable year for which it wishes to be excluded: a partnership return, as provided in subdivision (4) (i) of this subparagraph;

(B) For each subsequent taxable year for which it is excluded: Form I-10 for the organization and a Form I-9 for each person who was a member of the organization during any part of the calendar year. Form I-9 shall show the name and address of the organization (under "By Whom Paid"). Each such form shall state "Filed under M.S.A. 290.31, Subd. 26 (1)" and the principal activity of the organization.

(ii) Organizations partially excluded from M.S.A. 290.31 shall file partnership returns containing such information as the Commissioner may require upon the granting of the partial exclusion under M.S.A. 290.31, Subd. 26 (1).

(b) **Partnership agreement.** For the purposes of M.S.A. 290.31, a partnership agreement includes the original agreement and any modifications thereof agreed to by all the partners or adopted in any other manner provided by the partnership agreement. Such agreement or modifications can be oral or written. A partnership agreement may be modified with respect to a particular taxable year subsequent to the close of such taxable year, but not later than the date (not including any extension of time) prescribed by law for the filing of the partnership return. As to any matter on which the partnership agreement, or any modification thereof, is silent, the provisions of local law shall be considered to constitute a part of the agreement.

(c) **Liquidation of partner's interest.** The term "liquidation of a partner's interest" means the termination of a partner's entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership. A series of distributions will come within the meaning of this term whether they are made in one year or in more than one year. Where a partner's interest is to be liquidated by a series of distributions, the interest will not be considered as liquidated until the final distribution has been made. For the basis of property distributed in one liquidating distribution, or in a series of distrib-

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utions in liquidation, see M.S.A. 290.31, Subd. 13 (3). A distribution which is not in liquidation of a partner's entire interest, as defined in this paragraph, is a current distribution. Current distributions, therefore, include distributions in partial liquidation of a partner's interest, and distributions of the partner's distributive share. See paragraph (a) (1) (ii) of Reg. 2031 (12).

2032 (1) RETURNS FOR PERIODS LESS THAN 12 MONTHS.

(a) **Short period not caused by change of accounting period.** Whenever a return is required to be filed for a fractional part of a year for any reason other than that the taxpayer has changed his accounting period from one taxable year to another, the tax is computed in the same manner as though the return covered a full year. The requirements of paragraph (b) of this regulation (annualizing taxable net income and prorating credits allowable under M.S.A. 290.21) do not apply. Such an instance would arise where a corporation is organized or dissolved during the year.

(b) **Change of annual accounting period.** (1) **Returns for short period.** In the case of a change in the annual accounting period of a taxpayer, a separate return must be filed for the short period of less than 12 months beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year. However, such a return is not required for a short period of six days or less, or 359 days or more, resulting from a change from or to a 52-53-week taxable year. See M.S.A. 290.32 (2) and Reg. 2032 (2). In general, a return for a short period resulting from a change of annual accounting period shall be filed and the tax paid within the time prescribed for filing a return for a taxable year of 12 months ending on the last day of the short period.

(2) **Computation of tax.** If a return is made for a short period resulting from a change of annual accounting period, the taxable income for the short period shall be placed on an annual basis by multiplying such income by 12 and dividing the result

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by the number of months in the short period. The tax for the short period shall then be prorated according to the ratio which the number of months in such period bears to twelve months.

If a return is made for a short period of more than 6 days, but less than 359 days, resulting from a change from or to a 52-53-week taxable year, the taxable net income for the short period shall be annualized and the tax computed on a daily basis, as provided in M.S.A. 290.32 (2) and paragraph (c) (5) of Reg. 2032 (2).

2032 (2) ADOPTION OF OR CHANGE TO OR FROM 52-53 WEEK TAXABLE YEAR.

(a) **In general.** (1) A new taxpayer may adopt the 52-53-week taxable year for his first taxable year if he keeps his books and computes his income on that basis, or if he conforms his books accordingly in closing them. The taxpayer must thereafter keep his books and report his income on the basis of the 52-53-week taxable year so adopted unless prior approval for a change is obtained from the Commissioner. See paragraph (4) of this regulation. The taxpayer shall file with his return for his first taxable year a statement containing the information required in paragraph (3) of this regulation. A newly-formed partnership may adopt a 52-53-week taxable year, without the permission of the Commissioner only if such a year ends either with reference to the same month in which the taxable years of all its principal partners end or with reference to the month of December. See Reg. 2031 (6) (b) (1).

(2) A taxpayer, including a partnership, may change to a 52-53-week taxable year without the permission of the Commissioner if the 52-53-week taxable year ends with reference to the end of the same calendar month as that in which the former taxable year ended, and if the taxpayer keeps his books and computes his income for the year of change on the basis of such 52-53-week taxable year, or if he conforms his books accordingly in closing them. The taxpayer must continue to keep his books and compute his income on the basis of such 52-53-week taxable year unless prior approval for a change is obtained. See paragraph (4) of this regulation. The taxpayer shall indicate his election to change to such 52-53-week taxable year by a statement filed with his return for the first taxable year for which the election is made. This statement shall contain the information required in paragraph (3) of this regulation.

(3) The statement referred to in paragraph (1) and (2) of this regulation shall contain the following information:

(i) The calendar month with reference to which the new 52-53-week taxable year ends;

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(ii) The day of the week on which the 52-53-week taxable year always will end; and

(iii) Whether the 52-53-week taxable year will always end on (a) the date on which such day of the week falls in the calendar month, or (b) on the date on which such day of the weeks falls which is nearest to the last day of such calendar month.

(4) Where a taxpayer wishes to change to a 52-53-week taxable year and, in addition, wishes to change the month with reference to which the taxable year ends, or where a taxpayer wishes to change from a 52-53-week taxable year, he must obtain prior approval from the Commissioner, as provided in M.S.A. 290.07, Subd. 1 and Reg. 2007 (1).

(5) If a change from or to a 52-53-week taxable year results in a short period (within the meaning of M.S.A. 290.32 (2)) of 359 days or more, or six days or less, the tax computation under M.S.A. 290.32 (2) for putting the short period on an annual basis shall not apply. If the short period is 359 days or more, it shall be treated as a full taxable year. If the short period is six days or less, such short period is not a separate taxable year but shall be added to and deemed a part of the following taxable year. (In the case of a change from or to a 52-53-week taxable year not involving a change of the month with reference to which the taxable year ends, the tax computation under M.S.A. 290.32 (2) for putting the short period on an annual basis does not apply since the short period will always be 359 days or more, or six days or less). In the case of a short period which is more than six days but less than 359 days, taxable income for the short period shall be placed on an annual basis for the purpose of M.S.A. 290.32 (2) by multiplying such income by 365 and dividing the result by the number of days in the short period. In such case, the tax for the short period shall be the same part of the tax computed on such income placed on an annual basis as the number of days in the short period is of 365 days.
The standard deduction is not allowed on a return for a short period and personal credits must be prorated according to M.S.A. 290.06, Subd. 3 (7).

(6) The provisions of paragraph (5) are illustrated by the following examples:

Example (1). A taxpayer having a fiscal year ending April 30 elects for years beginning after April 30, 1955, a 52-53-week taxable year ending on the last Saturday in April. This election involves a short period of 364 days, from May 1, 1955, to April 28, 1956, inclusive. Since this short period is 359 days or more, it is not placed on an annual basis and is treated as a full taxable year.

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Example (2). Assume the same conditions as in example (1), except that the taxpayer elects for years beginning after April 30, 1955, a taxable year ending on the Tuesday nearest to April 30. This election involves a short period of three days, from May 1 to May 3, 1955. Since this short period is less than seven days, tax is not separately computed for it. This short period is added to and deemed part of the following 52-week taxable year which would otherwise begin on May 4, 1955, and end on May 1, 1956. Thus, that taxable year is deemed to begin on May 1, 1955, and end on May 1, 1956.

(b) **Computation of net income and taxable net income.** The principles of M.S.A. 290.07, Subd. 6, relating to the taxable year for inclusion of items of gross income, and M.S.A. 290.07, Subd. 7, relating to the taxable year for taking deductions, are generally applicable to 52-53-week taxable years. Thus, items of income and deductions are determined on the basis of a 52-53-week taxable year, except that such items may be determined as though the 52-53-week taxable year were a taxable year consisting of 12 calendar months if such practice is consistently followed by the taxpayer and if income is clearly reflected thereby. In the case of depreciation, unless some other practice is consistently followed, the allowance shall be determined as though the 52-53-week year were a taxable year consisting of 12 calendar months.

Amortization deductions for the taxable year shall be determined as though the 52-53-week year were a taxable year consisting of 12 calendar months.

2033 COMPUTATION OF TAX FOR FISCAL YEAR CHANGE OF RATES.

If a taxpayer files his return for a period beginning in one calendar year and ending in the following calendar year and the law applicable to the first calendar year is different from the law applicable to the second calendar year, the tax shall be computed as follows:

A corporation files its returns on a fiscal year ending June 30, 1939. Its net income for that period is $7,000.00. The specific credit allowed under M.S.A. 290.21 (1) is $1,000.00, and the contributions allowed as credits against this net income are $100.00. This leaves a balance subject to tax of $5,900.00.

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COMPUTATION OF TAX

Under 1938 Rate

1. Net Income (Exhibit A)		$7,000.00
2. Less: Specific Credit	$1,000.00	
3. Minnesota Contributions	100.00	
4. Total Credits		1,100.00
5. Balance Subject to Tax		$5,900.00
6. Tax on Item 5 (at 1938 rate) 7%		$ 41.30
7. Tax applicable to period prior to January 1, 1939 (6/12 of Item 6)		$ 20.65

Under 1939 Rate

8. Net Income (Exhibit A)		$7,000.00
9. Less: Specific Credit	$1,000.00	
10. Minnesota Contributions	100.00	
11. Total Credits		1,100.00
12. Balance Subject to Tax		$5,900.00
13. Tax on Item 12 (at 1939 rate) 6%		$ 35.40
14. Tax applicable to period subsequent to January 1, 1939 (6/12 of Item 13)		$ 17.70
15. Plus Tax Item 7		20.65
16. Tax applicable to period (Item 14 plus Item 15)		$ 38.35
17. Property Payroll Credit (not to exceed 10% of Item 16)		3.84
18. Tax for Fiscal Year (Item 16 minus Item 17)		$ 34.51

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2034 (1) EVASION OF TAX BY CORPORATIONS.

In any case where a corporation, which is liable to taxation under this Act, conducts business transactions with its members or stockholders, or with any person or corporation interested in the business of such corporation, in such a manner as to reduce the taxable net income attributable to this State, the Commissioner may determine the income of the corporation so as to reflect what would have been its reasonable taxable net income but for such business transaction. Among others, the following devices commonly employed to distort income attributable to this State will not be recognized in determining taxable net income:

(a) The purchase, or sales, by or between corporations or others at a price greater or less than the price paid in the usual course of business by independent purchasers.

(b) The fixing of income at an arbitrary figure by contract or agreement.

(c) The payment of arbitrary amounts for so-called advisory, management or counseling services.

(d) Arbitrary charges for, or allocation of, improper overhead expenses, such as officers' salaries, rents, auditing, etc.

(e) Arbitrary agreements for the purchase, or sale of, goods or services at fixed prices, or on a basis of cost, actual or estimated, or on a basis of cost plus a fixed percentage or amount.

2034 (2) CONSOLIDATED STATEMENTS.

The Commissioner may permit or require consolidated statements where it appears that the income of a corporation operating in this State cannot be determined without reference to the operations of other corporations with which such company may be affiliated. The purpose of consolidated statements is to aid in the determination of the net income properly received by the affiliated or related corporations, and such statements should be distinguished from consolidated returns of the combined taxable net income of all corporations in the consolidation.

Consolidated statements may be required where a corporation has its income regulated through contract or other arrangement with its stockholders or affiliated interests. Such an instance might arise where a corporation's income is improperly reduced through the payment of excessive expenses to stockholders or affiliated interests. The taxable net income may be determined without regard to the allowance of such expenses which are deducted by the corporation in excess of a fair and reasonable amount.

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2034 (3) CONSOLIDATED RETURNS.

An affiliated group of corporations which comes within the purview of M.S.A. 290.34, Subd. 3 has the privilege of filing a consolidated return in lieu of separate returns. The privilege of making a consolidated return for any taxable year of an affiliated group must be exercised at the time of making the return of the common parent corporation for such year. Under no circumstances can such privilege be exercised at any time thereafter. The filing of separate returns for a taxable year does not constitute an election binding upon the corporations in subsequent years; however, if the privilege is exercised at the time of making the return, separate returns cannot thereafter be made for such year.

The consolidated return must include the income of the common parent corporation and of each subsidiary for the entire taxable year. If a corporation becomes a member of the affiliated group during the taxable year of the group, the consolidated return must include its income from the time when it became a member of the group. The taxable year of the common parent corporation shall be considered as the taxable year of the affiliated group which makes a consolidated return, and the consolidated net income must be computed on the basis of the taxable year of the parent corporation. The net income of the several corporations shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations subject to the elimination of unrealized profit and losses in transactions between members of the affiliated group and intercompany transactions. The statement of gross income and deductions must be set forth in the consolidated return in such a manner that the details of the items of gross income, deductions, and credits for each member of the affiliated group may be readily ascertained. Only one credit provided by M.S.A. 290.21 (1) shall be allowed in computing the tax on such consolidated return.

For the purpose of determining consolidated net income all members of the affiliated group shall adopt that method of accounting which clearly reflects the consolidated net income. A method of accounting which does not treat with reasonable consistency all items of gross income and deductions of the various members of the group shall not be regarded as clearly reflecting the consolidated net income. If the members of an affiliated group have established different methods of accounting, each member may retain such method with the consent of the Commissioner provided that the consolidated net income is clearly reflected, and provided further that intercompany transactions affecting consolidated net income between members of the group shall be eliminated and adjustments on account of such transactions

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shall be made with reference to a uniform method of accounting to be selected by the members of the group with the consent of the Commissioner.

2035 ALLOCATION OF INCOME BY INSURANCE COMPANIES.

Insurance companies not coming within the purview of M.S.A. 290.05 (3) shall file returns with the Commissioner on Form I-6 if they are not classed as life insurance companies. The Commissioner will consider that a return prepared in either one of the two following ways will be sufficient to satisfy the statute: Either fill in Schedule I-4 and I-6 together with Schedule T provided the property payroll credit is claimed, or the taxpayer may attach a copy of the net income computation and surplus reconciliation from his Federal income tax return and attach a copy of the annual insurance department statement.

Insurance companies which do not come within the purview of M.S.A. 290.35 by reason of their having been accorded an exemption from the duty of filing Federal income tax returns, and which do not come within the purview of M.S.A. 290.05 (3) need not file a Minnesota income tax return provided they execute the affidavit on Form 133 (a) which declares that the taxpayer cannot report to the Commissioner "net income returned by it for the taxable year to the United States under the provisions of the Act of Congress known as the Revenue Act of 1936" because it has been specifically granted exemption from the duty of filing returns and paying the tax under appropriate Federal revenue acts. Life insurance companies must use Form I-7.

The term "gross premiums collected" is considered to be gross premiums less premium rebates.

The term "net income" appears in M.S.A. 290.35 without qualification. Any credits against taxable net income provided for by the Federal Revenue Act of 1936 are not to be considered in determining Minnesota taxable net income.

It will be observed that the statute required that the Federal Revenue Act of 1936 must be controlling in determining taxable net income under this Act even though it is no longer controlling in the determination of Federal taxable net income by reason of its being superseded by subsequent revenue acts.

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2036.1 (2) COMPUTATION OF TAXABLE NET INCOME.

(a) **Gains and losses.** In determining gain or loss from sale or other disposition of assets, the provisions of M.S.A. 290.12, 290.13, 290.14 and 290.15 shall apply to national and state banks except that in no case will the fair market value as of January 1, 1933, be used as the loss or gain basis. For the purpose of determining a gain the fair market value as of January 1, 1940, shall be used as the basis if such value after adjustments exceeds the cost after adjustments. However, for the purpose of determining a loss cost must be used as the basis and not the fair market value as of January 1, 1940. If property acquired before January 1, 1940, is sold or disposed of for more than cost, as adjusted, and for less than its January 1, 1940, fair market value, as adjusted, no gain or loss is recognized.

For taxable years beginning after December 31, 1946, property consisting of investments in bonds, stocks, notes, debentures, mortgages, certificates, or any evidence of indebtedness, and any property acquired in liquidation thereof when such property is held for investment or for sale are not considered to be capital assets. Gains from the sale or other disposition of such assets are includible in income in full. Losses are deductible in full.

(b) **Depreciation.** In no case shall fair market value as of January 1, 1933, be used as the basis for computing depreciation under the provisions of this Act. Banking corporations shall use either cost or fair market value as of January 1, 1940, as the basis for computing depreciation. However, M.S.A. 290.16, Subd. 1, provides that the basis upon which exhaustion, wear, tear, obsolescence, or depletion is computed shall be the same as that for the purpose of determining loss or gain on the sale of property.

Thus, if depreciation is computed and allowed on the basis of value as of January 1, 1940, and it later appears, when the asset is sold, that cost must be used as the loss or gain basis, adjustments must then be made for excessive depreciation in prior years in the amount that the depreciation which was allowed exceeds that depreciation allowable when computed on the basis of cost.

(c) **Charge-offs, write-downs, and recoveries relating to bad debts.** Under the provisions of M.S.A. 290.09, Subd. 6, national and state banks will be allowed to deduct debts which become worthless and are charged off during the taxable year. If a bad debt becomes worthless in part during the taxable year, a deduction

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may be taken to the extent of such partial worthlessness. If a bad debt is ordered charged off in whole or in part by national or state authorities, such determination shall be considered as prima facie evidence of worthlessness.

Where a debt has been deducted from the gross income subsequent to January 1, 1940, and the taxpayer realized a recovery of all or part of such debt, the amount so recovered constitutes taxable income only to the extent that a tax benefit resulted in the year of deduction. If the debt was charged off prior to January 1, 1940, and all or part of such debt is recovered subsequent to January 1, 1940, no part of such recovery will constitute taxable income.

If the Federal or State banking authorities require that an asset be charged off as worthless or that it be written down to nominal value, such determination will be considered as prima facie evidence of worthlessness. If such determination is based upon market fluctuation or if no reasonable attempt has been made to determine worthlessness, such action on the part of Federal or State banking authorities will not be considered conclusive evidence of worthlessness. No deduction for income tax purposes of the amount so charged off or written down will be allowed unless other evidence is submitted substantiating that such asset actually became worthless during the taxable year.

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2038 (1) JOINT RETURNS.

Every person married and living with his spouse at the close of the taxable year must file a return if either of the following conditions exist:

(1) The tax on his own taxable net income or the tax on the combined taxable net income of himself and his spouse exceeds the allowable specific credits as provided in M.S.A. 290.06; or

(2) His gross income or the combined gross income of himself and his spouse exceeds $2,000.

See Reg. 2037 (1).

If a husband and wife living together at the close of the taxable year each had separate income during the taxable year, they may either file a joint return or separate returns. Regardless of whether a joint return or separate returns are filed, the total income of both spouses must be reported. *Example*: Gross income of the husband $5,000; gross income of the wife $125. The income of both the husband and wife must be reported either in a joint return or in separate returns.

If one spouse did not have separate income of his own, the spouse who did not have separate income cannot file a separate return. However, a husband and wife living together at the close of the taxable year may make a joint return even though one of the spouses had neither gross income nor deductions.

If the income of a husband and wife is included in a joint return, the tax is computed on the aggregate income and all deductions and credits shall be taken from such aggregate income. However, if separate returns are filed, each spouse must include only his own separate income in his return.

In determining whether persons are married or single, the determination is made as of the last day of the taxable year.

No joint return can be made if the husband and wife have different taxable years. However, an exception to this rule is made in the case where one spouse died during the taxable year (see Reg. 2038 (2)).

In the case of a joint return, the liability with respect to the tax is both joint and several.

Persons who become married during the taxable year may file a joint return if they are married and living together at the close of the taxable year. Married persons who were separated during any part of the taxable year may file a joint return if they were married and living together at the close of the taxable year. In either case, a joint return must include all of the income each spouse received during the taxable year, and the credit allowed

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for married persons must be prorated so that such credit is claimed only for the part of the taxable year the persons were married and living together. For proration of credits, see Reg. 2006 (3) (d).

A joint return must be signed by both the husband and wife unless (a) the return is made by an agent of both the husband and wife, or (b) one spouse signs as the agent of the other. Any spouse who makes a joint return through an agent shall assume the responsibility for making the return and incur liability for the penalty provided for erroneous, false, or fraudulent returns. One spouse cannot sign as the agent of the other unless the return is accompanied by a power of attorney authorizing such action by the spouse not signing the return. Other agents must also submit their power of attorney with the return.

The election of a husband and wife to file a joint return or separate returns may be changed by said husband and wife at any time within the period provided by the statute for the assessment of additional taxes, that is, three and one-half years from the time of the filing of the return in question.

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2039 FORM OF RETURN.

Income Tax forms shall be prescribed by the Commissioner and shall be executed and filed in accordance with these regulations and the instructions on the form or issued therewith. Copies of the prescribed return forms will so far as possible be furnished to taxpayers. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the Income Tax Division of the Department of Taxation, St. Paul, Minnesota, in ample time to have their returns prepared, sworn to, and filed on or before the due date. Each taxpayer should carefully prepare his return so as to fully and clearly set forth the data called for. Only returns which have been so prepared will be accepted as meeting the requirements of this Act and will start the period of limitations in favor of the taxpayer.

Since M.S.A. 290.01, Subd. 19, provides that the term "net income" shall mean gross income as defined in M.S.A. 290.01, Subd. 20, and 290.08, less deductions allowed by M.S.A. 290.09, and since M.S.A. 290.01, Subd. 22, provides that the term "taxable net income" shall mean net income assignable to this State, the return must reflect total gross income, total deductions, and the resulting net income, and then the allocation or assignment of the net income or its component gross income and deductions, in accordance with the assignment of income in M.S.A. 290.17, 290.18, 290.19 and 290.20. For example, a taxpayer filing a return on the separate accounting method must include as a part of the return, gross income and deductions for the corporation in its entirety and balance sheets of the corporation's entire assets, together with the appropriate surplus reconciliation, as well as gross income and deductions assigned as Minnesota items in the determination of Minnesota taxable net income.

An individual taxpayer having income from a trade or business carried on partly within and partly without this State must reflect in his return total gross income and deductions, and the resulting net income, and then the allocation or assignment of the net income or its component gross income and deductions, in accordance with the assignment of income in M.S.A. 290.17, 290.18, 290.19 and 290.20.

The same rule applies with respect to partnership and fiduciary returns.

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2040 (1) RETURNS IN CASE OF DEATH OF TAXPAYER.

(a) **Return of Decedent.** In the case of the death of a taxpayer during his taxable year, a return shall be filed for the fractional year beginning with the date of the commencement of his taxable year and ending with the date of death, unless a return is filed in accordance with M.S.A. 290.38 (see Reg. 2038 (2)). For date return is required to be filed see Reg. 2042 (1).

(b) **Return of Estate.** The first return of the estate of a deceased person shall be filed (1) for the period commencing with the date of his death and ending with the last day of his normal taxable year, or (2) for a fiscal year of not more than 12 months commencing with the date of the decedent's death. If the executor or administrator files a return for a fiscal year beginning with the date of death, such fiscal year must end on the last day of a calendar month and may not be for a period in excess of 12 months. For date return is required to be filed, see Reg. 2042 (1).

2040 (2) ELECTION OF YEAR CONSISTING OF 52-53 WEEKS.

(a) **General rule.** Section 290.40 provides, in general, that a taxpayer may elect to compute his net income and taxable net income on the basis of a fiscal year which—

(1) Varies from 52 to 53 weeks.

(2) Ends always on the same day of the week and

(3) Ends always on—

(i) Whatever date this same day of the week last occurs in a calendar month, or

(ii) Whatever date this same day of the week falls which is nearest to the last day of the calendar month.

For example, if the taxpayer elects a taxable year ending always on the last Saturday in November, then for the year 1956, the taxable year would end on November 24, 1956. On the other hand, if the taxpayer had elected a taxable year ending always on the Saturday nearest to the end of November, then for the year 1956, the taxable year would end on December 1, 1956. Thus, in the case of a taxable year described in (3) (i), the year will always end within the month and may end on the last day of the month, or as many as six days before the end of the month. In the case of a taxable year described in (3) (ii), the year may end on the last day of the month, or as many as three days before or three days after the last day of the month.

(b) **Application of effective dates.** (1) For the purpose of determining the effective date for the applicability of any provision of this chapter which is expressed in terms of taxable years beginning or ending with reference to the first or last day

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of a specified calendar month, including the time for filing returns and other documents, paying tax, or performing other acts, a 52-53-week taxable year is deemed to begin on the first day of the calendar month beginning nearest to the first day of the 52-53-week taxable year, and is deemed to end or close on the last day of the calendar month ending nearest to the last day of the 52-53-week taxable year, as the case may be. The preceding sentence does not apply to the computation of tax if paragraph (2) of this regulation relating to the computation under M.S.A. 290.33 of the effect of changes in rates of tax during a taxable year, applies. The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume that an income tax provision is applicable to taxable years beginning on or after January 1, 1957. For that purpose, a 52-53-week taxable year beginning on any day within the period December 26, 1956, to January 4, 1957, inclusive, shall be treated as beginning on January 1, 1957.

Example (2). Assume that an income tax provision requires that a return must be filed on or before the 15th day of the third month following the close of the taxable year. For that purpose, a 52-53-week taxable year ending on any day during the period May 25 to June 3, inclusive, shall be treated as ending on May 31, the last day of the month ending nearest to the last day of the taxable year, and the return, therefore, must be made on or before August 15.

(2) If a change in the rate of tax is effective during a 52-53-week taxable year (other than on the first day of such year as determined under paragraph (1) of this regulation), the tax for the 52-53-week taxable year shall be computed in accordance with M.S.A. 290.33, relating to effect of changes, and the regulations thereunder. For the purpose of the computation under M.S.A. 290.33, the determination of the number of days in the period before the change, and in the period on and after the change, is to be made without regard to the provisions of paragraph (1) of this regulation. The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume a change in the rate of tax is effective for taxable years beginning after June 30, 1956. For a 52-53-week taxable year beginning on Wednesday, November 2, 1955, the tax must be computed on the basis of the old rates for the actual number of days, from November 2, 1955 to June 30, 1956, inclusive, and on the basis of the new rates for the actual number of days from July 1, 1956, to Tuesday, October 30, 1956, inclusive.

Example (2). Assume a change in the rate of tax for taxable years beginning after June 30. For this purpose, a 52-53-week taxable year beginning on any of the days from June 25,

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to July 4, inclusive, is treated as beginning on July 1. Therefore, no computation under M.S.A. 290.33 will be required for such year because of the change in rate.

2040 (3) RETURNS IN CASES WHERE ACCOUNTING PERIOD IS CHANGED.

Generally, no return can be made for a period of more than twelve months (but see M.S.A. 290.40 (2)). A separate return for a fractional part of a year is therefore required whenever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in M.S.A. 290.32. The requirements with respect to the filing of a separate return incident to a change in accounting period and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. For the computation of the tax due, see M.S.A. 290.32 and Reg. 2032.

2041 (1) PARTNERSHIP RETURNS.

Every partnership (including syndicates, groups, pools, joint ventures, or other unincorporated organizations, through or by the means of which any business, financial operation or venture is carried on, and which are not trusts, estates, limited partnerships, or corporations within the meaning of the Minnesota Income Tax Act of 1933 and acts amendatory thereof), whose gross income or any portion thereof is assignable to this State, is required to make a return for each taxable year on Form I-3 sworn to by one of the partners.

The return shall specifically set forth the items of gross income, deductions, names and addresses of partners, marital status of the partners, salaries of the partners as determined by the partnership agreement, the percentage of the net income, the distributive share of each, and any other data required under the Act. If any basis of distribution other than a straight fractional part of net income is used, complete details must accompany the return to substantiate this distributive share. The return shall also set forth a comparative balance sheet listing assets and liabilities for the beginning and ending of the taxable period, together with an analysis of the partners' investment account and a reconciliation of book income with income for tax purposes.

Every partnership whose business is carried on partly within and partly without this State must also file Form I-5, which is available upon application from the Commissioner.

It is imperative that Schedule T of Form I-5 be completed and made a part of the return, regardless of the method used for assigning income to this State. If a separate accounting for Minnesota business is used to reflect income assignable to this State, Schedules U and V of Form I-5 must be completed.

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2041 (2) Information returns.

(a) In general. If a corporation, individual, partnership, estate trust, or fiduciary in the regular course of a trade or business makes payments during the calendar year of salaries, wages, fees, commissions, bonuses, rents, royalties, interest or dividends to another corporation, individual, partnership, estate, trust, or fiduciary, and if such payments fall into any of the categories listed below, the corporation, individual, etc., making the payments shall file returns of information on Form M-9 and execute Form M-10 under oath. The categories are as follows:

(1) Salaries, wages, fees, commissions, bonuses, etc., in excess of $600, paid to all residents or similar payments to non-residents engaged in performance of personal services within this state.

(2) Rents and royalty paid in excess of $600 on property located within this state whether paid to residents or non-residents.

(3) Dividends in excess of $10 paid to residents of Minnesota.

(4) Interest of $10 or more paid to residents of Minnesota.

(5) Other fixed or determinable income in excess of $500 in any calendar year.

(6) Earnings in excess of $10 distributed by savings, building and loan associations to its members.

Sums paid in respect of life insurance, endowment or annuity contracts come within the meaning of the term, "fixed or determinable income."

For the purpose of the return of information, an amount is deemed to have been paid when it is credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment, or condition upon which payment is to be made and which is made available to him so that it may be drawn at any time and its receipt brought within his control and disposition.

The duty to file Forms M-9 and Forms M-10 is also imposed upon (1) organizations which are tax exempt under Minnesota Statutes, section 290.05 and (2) individuals, corporations, estates, trust, partnerships and fiduciaries which are not required to file returns under Minnesota Statute, section 290.37.

These returns shall be filed on or before April 15th succeeding each calendar year unless written permission for an extension has been granted by the commissioner and must always show payment for the preceding calendar year even in case where

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the taxpayer's records are kept on a fiscal year basis.

(b) Payments to public employees. On or before March first of each year the state treasurer and the treasurer or other corresponding officer by whatever name known, of any political subdivision of the state, of every city, village or borough, and of every school district shall complete and file returns of information with the commissioner on Forms M-9 and M-10 with respect to payments of salaries or wages in excess of $600 made during the preceding calendar year to employees or officials of such political subdivision, city, village, borough, or school district.

In cases where payments are made by the state treasurer or the treasurer or other disbursing officer by whatever name known of any political subdivision, where such disbursing officer has inadequate records, the returns of information shall be made by the heads of the executive departments. However, it shall be the duty of such disbursing officers to acquaint the departmental executive heads in writing of their responsibilities regarding the act and receive acknowledgment thereof in writing.

(c) Information as to actual owner. When the person receiving a payment falling within the provisions of the act for information at the source is not the actual owner of income received, the name and address of the actual owner shall be furnished upon demand upon the individual, corporation, partnership or fiduciary paying the income and if in default of a compliance with such demand the payee becomes liable for the tax and penalties provided. Upon receipt of dividends by a record owner he should execute Form M-9 in duplicate disclosing the name and address of the actual owner or payee with the commissioner not later than April 15th.

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2042 (1) DATE FOR FILING RETURNS.

(a) **Returns of Income.—**

(1) **General rule.** Returns of income must, as a general rule, be filed not later than the 15th day of the fourth month following the close of the taxable year. Special rules apply to corporations, estates and trusts, and decedents (see paragraphs (2), (3), and (4) below).

(2) **Corporations.** Returns of income of corporations must be filed not later than the 15th day of the third month following the close of the taxable year.

(3) **Estates and Trusts.—**

Final returns. Upon the completion of the administration of an estate and allowance of his final accounting, an executor or administrator may immediately file a return of income of the estate for the taxable year in which the administration was closed. Similarly, upon the termination of a trust, the trustee may immediately make a return for the taxable year terminated by the close of the trust. Although the return may be filed earlier, any return required to be filed at the close of an estate or trust must be filed not later than the 15th day of the fourth month following the end of the month in which the estate was closed or the trust terminated.

(4) **Decedents.** In the case of the death of a taxpayer during his taxable year, a return shall be filed for the fractional year beginning with the date of the commencement of his taxable year and ending with the date of death, unless a return is filed in accordance with M.S.A. 290.38. This return (a return not filed in accordance with M.S.A. 290.38) must be filed not later than the 15th day of the fourth month following the close of the twelve month period which began with the first day of such fractional part of a year.

(b) **Returns of Information.—**

(1) **Partnership.** Partnership returns must be filed not later than the 15th day of the fourth month following the close of the taxable year.

(2) **Form I-9 and Form I-10.** Returns of information on Form I-9 and Form I-10 must be filed not later than the 15th day of April of each year.

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2042 (6) EXTENSION OF TIME FOR FILING RETURN.

(a) **General rule.** Whenever in his judgment good cause exists by reason of sickness, absence or otherwise, the Commissioner may upon application diligently filed, extend the time for filing returns. Such extension shall not exceed six months except in the case of a taxpayer who is outside of the United States (see paragraph (b) of this regulation). If an extension of time for filing is granted to a taxpayer, other than a corporation taxpayer, such extension applies not only to the time for filing but also operates as an extension of time for payment of any tax which may be due within the extended period. However, interest accrues on such unpaid tax at the statutory rates (see Reg. 2053 (1) (b)).

(b) **Taxpayers outside of the United States.** A civilian outside of the United States continuously for more than 90 days receives an automatic extension of time to file a return and pay his taxes. In such a case the taxpayer does not need to make an application for the extension. This automatic extension is for the period the taxpayer was outside of the United States and for a further period of six months after his return to the United States. (See M.S.A. 290.65, Subd. 2.)

The Commissioner may, in the case of a taxpayer who is outside of the United States, extend the time for filing a return and paying the tax thereon until 30 days after the taxpayer's return to this State if an application for such extension is diligently filed (see paragraph (d) of this regulation).

(c) **Members of the Armed Forces.** For rules covering extensions of time granted to members of the Armed Forces for filing returns and paying taxes, see M.S.A. 290.65 and the regulations thereunder.

(d) **How to make application for extension of time.** Taxpayers, who wish an extension of time to file a return should complete and file Form 522E in duplicate before the due date of the return.

If a corporate taxpayer desires an extension of time to file a return, it must, in addition to making appropriate application on Form 522-C pay the tax shown thereon in accordance with the provisions of M.S.A. 290.45. The procedure outlined in this paragraph shall be applicable to applications made with respect to returns for taxable years commencing after December 31, 1963.

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2045 (1) TIME FOR PAYMENT OF TAX.

M.S.A. 290.45 provides that individual taxpayers shall pay the tax due in full on or before the time fixed for filing the return. Estates and trusts at their election may pay the tax due in two equal installments, the first at the time fixed for filing the return and the second on or before six months thereafter.

The law provides that as to corporate taxpayers electing to pay on the installment basis, the first is due at the time fixed for the filing of the return and the balance on or before three months thereafter. (See M.S.A. 290.42 and the regulations thereunder for due dates for filing returns.)

If an installment is not paid in full on or before the date fixed for its payment either by the terms of this Act or by the Commissioner in accordance with the terms of an extension, the whole amount of unpaid balance shall become due and payable.

In any case where a taxpayer submits a timely remittance for one-half or more of his total tax liability as disclosed by his return, it shall be considered that the taxpayer has elected to pay his tax in installments.

For penalties and interest, see M.S.A. 290.53 and the regulations thereunder.

2045 (4) RECEIPTS FOR TAX PAYMENTS.

For every payment in cash the taxpayer should require and the Commissioner shall furnish a receipt therefor. In case of payments made by check or money order the cancelled remittance is usually a sufficient receipt. However, upon request, a receipt will be given for each tax payment.

2049 TIME LIMIT ON ASSESSMENT AND COLLECTION.

(a) **In general.** Except as otherwise provided in Chapter 290 and except for the special circumstances referred to below, the

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period of limitations upon the assessment of tax for a taxable year ending after January 1, 1937, runs in favor of the taxpayer three and one-half years from the date the return was filed. In the absence of a waiver agreement pursuant to M.S.A. 290.49, Subd. 8, an assessment is not valid if made after such period. For the purposes of applying the statute of limitations herein referred to, a return filed before the last day prescribed by law for the filing thereof is considered as filed on such last day. (For special rules applying to taxable years 1943-1946, see M.S.A. 290.49, Subd. 9.)

(b) **Omission of 25 per cent of gross income.** Where a taxpayer has omitted from gross income an amount properly includible therein in excess of 25 per cent of the gross income as stated in the return, the statute of limitations does not run until six and one-half years after the return was filed.

(c) **Omission of gain on liquidation.** Where a taxpayer omits an amount from gross income which was properly includible therein as gain on the liquidation of a corporation, the statute of limitations does not run until 6½ years after the return was filed.

(d) **False or fraudulent return; no return filed.** In the case of a false or fraudulent return or failure to file a return, an assessment may be made at any time.

(e) **Request for application of special statute of limitations.** The period of limitations set forth above applies to all taxpayers. However, in the case of income received during the lifetime of a decedent or by his estate during the period of its administration or by a trustee of a terminating trust or other fiduciary who, because of custody of assets would be liable for the payment of tax under M.S.A. 290.54, or by a corporation contemplating dissolution, the tax shall be assessed within eighteen months after written request therefor by the fiduciary or legal representative of the estate or by the corporation, but not after the expiration of three and one-half years after the return was filed. A request, in order to start the eighteen month limitation, must be made after the return is filed and must be in such language as to make it clear to the Commissioner that it is desired to take advantage of M.S.A. 290.49, Subd. 2.

Furthermore, in the case of corporation contemplating dissolution the eighteen month period shall apply only if the conditions of clauses 1, 2 and 3 of M.S.A. 290.49, Subd. 2, are fully complied with.

(f) **Sale of personal residence.** The statutory period for the assessment of any deficiency attributable to any part of a gain from the sale of a personal residence sold after December 31, 1950, shall not expire prior to 3½ years after the Commissioner is notified as provided in Reg. 2013 (9) (i).

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2050 (1) PROCEDURE AND TIME LIMITATIONS ON CLAIMS FOR REFUNDS.

(a) **Procedure.** Claims by the taxpayer for the refund of taxes, interest, or penalties erroneously or illegally paid or collected may be filed with the Commissioner. The Commissioner has prepared Form I-500 for the convenience of taxpayers claiming refunds under M.S.A. 290.50 which is available upon application to the Income Tax Division. The claim must set forth in detail, and under oath, the reasons for such claim and it must be supported by sufficient legal and accounting data to enable the Commissioner to pass upon its merits.

The taxpayer should file a claim for refund in every case for the purpose of advising the Commissioner of the grounds upon which the claim is based and to preserve any rights of the taxpayer which might otherwise be lost by the running of the statute of limitations.

At the election of the taxpayer the filing of an amended return after April 14, 1965, pursuant to M.S.A. Section 290.391 will serve as a claim for refund.

After a claim for refund is filed, the Commissioner will examine the claim and will send the taxpayer by mail his written findings allowing or denying the claim in whole or in part.

No refund will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed prior to the expiration of such period.

A claim which does not set out the specific grounds upon which the claim is based will not be considered as a claim for refund for any purpose.

When the inclusion in gross income or a disallowance of a deduction has been the subject matter of an assessment of tax and the assessment has become final and conclusive as provided in M.S.A. 290.51 after the adjustments of an order of the Commissioner, no claim or credit will be later considered in respect to such item.

If the taxable net income of a taxpayer has been finally determined by the Commissioner upon the same basis of fact and law advanced in the claim for refund, the Commissioner will not again re-open a taxable year having been so determined.

If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letter of administration, or other similar evidence must be annexed to the claim to show the authority of the executor, administrator, guardian, trustee, receiver or other fiduciary files a return and thereafter a refund

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claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title under oath of the officer having authority to sign for the corporation.

Where a claim for refund is signed by an agent for the taxpayer, such claim must be accompanied by a written power of attorney from such taxpayer.

Except in cases where there has been an overpayment (estimated tax payments or prepayment) or tax withheld in excess of a self-assessed liability as shown on the return filed by the taxpayer, M.S.A. 271.12 provides that no order or refundment by the Commissioner shall take effect until the time for appeal by all the parties has expired, which is usually a thirty-day period. After the expiration of such period for appeal, a certificate or refundment is transmitted to the State Auditor who causes a warrant to issue. In the average case this procedure necessitates a thirty day interval between the time that the order for refundment issues and the time that such refund is received by the taxpayer. (See M.S.A. 290.46, 290.92, Subdivision 13 and 290.93, Subdivision 9 relative to refunds of amounts in excess of liability reflected on return.)

(b) **Time limitations.** A claim for refund can be entertained only if it is filed within three and one-half years after the return was filed or within two years after the tax was paid or collected. This limitation applies generally to all claims for refund filed after April 28, 1941, and to all taxable years since the basic date of the Act. However, if the claim relates to a taxable year beginning after December 31, 1942, or ending before December 31, 1946, it may be filed within two years after the tax was paid or collected or within four and one-half years after the return was filed.

If the refund claim is based on an overpayment on account of the taxpayer's failure to claim a deduction for a bad debt or a security becoming worthless, such claim may be filed within five years from the date the return was filed. The statute of limitations for filing a claim under this provision on or before April 28, 1947, was seven years. The amount of a refund under this provision is limited to the amount of the overpayment due to the failure to deduct such bad debt or loss.

If a claim for refund is not filed within three and one-half years after the return was filed (four and one-half years in the case of a taxable year beginning after December 31, 1942, or ending before December 31, 1946) or within five years after the return was filed to the extent that it refers to failure to claim bad debts or worthless stock losses, the refund cannot exceed the amount paid within the two year period preceding the filing of such claim.

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For the purpose of computing the period of limitations within which a claim may be filed M.S.A. 290.49, Subd. 5, specifically provides that a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

If the claim for refund, filed by an individual, corporation or other taxpayer, relates to an overpayment attributable to a net operating loss carryback, such claim may be filed not later than the 15th day of the 45th month following the end of the taxable year of the net operating loss which results in the carryback giving rise to the claim. (See M.S.A. 290.095, Subdivision 7(c) and Regulation 2009.5(7)-4 for limitations and rules relating to such claims.)

NOTE: For special time limitations on claims based upon a net operating loss carryback, see Reg. 2009.5(7)-4.

2050 (5) OVERPAYMENTS; CREDITS AND REFUNDS

(a) Authority to make credits or refunds. The Commissioner, within the applicable period of limitations, may credit any overpayment of tax, including interest thereon, against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the taxpayer making the overpayment, and the balance, if any, shall be refunded to such taxpayer by the Commissioner.

(b) Credit against estimated tax properly executed. Income tax return shall, at the election of the taxpayer, constitute a claim for refund or credit of an overpayment as defined in M.S.A. 290.50, Subd. 5 for the amount of the overpayment disclosed by such return. For the purposes of M.S.A. 290.50 such claim shall be considered as filed on the date on which the return is considered as filed.

An election to treat the return as a claim for refund or credit shall be evidenced by a statement on the return setting forth the amount determined as an overpayment and advising whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated income tax for the taxable year immediately succeeding the taxable year for which such return is filed. If the taxpayer elects to have all or part of the overpayment shown by his return applied to his estimated income tax for his succeeding taxable year, no interest shall be allowed on such portion of the overpayment credited and such amount shall be applied as a payment on account of the estimated income tax for such year or the installments thereof.

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In any case in which a taxpayer elects to have an overpayment refunded to him he may not thereafter change his election to have the overpayment applied as a payment on account of his estimated income tax.

(c) Overpayment of installment. If any installment of tax is overpaid, the overpayment shall first be applied against any outstanding installments of such tax. If the overpayment exceeds the correct amount of tax due, the overpayment shall be credited or refunded as provided in this regulation.

2052 (1) INCOME TAX DIVISION.

Pursuant to the authority granted under the provisions of Article VI, Chapter 431, Laws of Minnesota, 1939, the Commissioner of Taxation has established a unit to handle the details of the administration of this Act. This unit is officially designated as the "Income Tax Division" of the Department of Taxation.

The term "Division" as used in these regulations shall mean the "Income Tax Division."

2052 (2) AUDIT AND REVIEW.

If upon field examination of the taxpayer's books of account and records or after an office examination of an income tax return, facts are obtained which, in the opinion of the Commissioner, warrant an adjustment of tax liability, a proposed assessment report is prepared and mailed to the taxpayer. This report contains a complete explanation of adjustments together with a recomputation of tax liability.

In the event the taxpayer acquiesces in the changes reflected in the proposed assessment report or fails to file a protest within thirty days after receipt thereof, the Commissioner issues an order in accordance with the proposed assessment report, adding thereto statutory interest and penalty, if any.

In a case where a taxpayer does not acquiesce in the proposed assessment, he may file a protest within the thirty day period specified in the letter accompanying the proposed assessment report. With respect to the proper form to be used in filing such protest, see Reg. 2052 (3). If after a review of the taxpayer's protest, the Division is unable to acquiesce therein, the taxpayer will be afforded an opportunity to have a hearing before a representative of the Division upon request. If the tax-

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payer and the Division are in agreement after such hearing, either the proposed assessment will be cancelled or an order of the Commissioner will issue in accordance with the terms of the agreement. In case the taxpayer does not acquiesce in the position taken by the Division, he may request a hearing with respect to the same issues before the Commissioner of Taxation.
If the taxpayer does not desire such a hearing, an order will be issued immediately. If a hearing before the Commissioner is requested and granted, an order will not be issued until such time as the Commissioner has made a final determination.

With the exception of the provisions of M.S.A. 271.06, Subd. 5 and 271.12, the issuance of an order by the Commissioner of Taxation constitutes a final determination. The taxpayer is granted a period of thirty days from the date of the mailing of such order within which to file an appeal with the Minnesota Board of Tax Appeals.

The procedure outlined in this regulation shall not preclude the Commissioner from imposing immediate assessments under circumstances where the statute of limitations is about to run with respect to any return, or where the Commissioner has reasonable grounds for believing that the collection of any taxes, interest or penalties due under this Act, will be jeopardized.

Every order of the Commissioner shall take effect immediately upon the filing thereof and no appeal therefrom or review thereof shall stay the execution thereof or extend the time for the payment of any tax or other obligation unless otherwise expressly provided by law except that no order for refundment by the Commissioner shall take effect until the time for appeal therefrom or review thereof by all parties entitled thereto has expired. For penalties and interest in the case of non-payment within the thirty day period after the issuance of such order, see Regs. 2053 (1) and 2053 (2).

2052 (3) FORM OF PROTEST.

The protest, of which there must be two copies, should be executed under oath, and should contain the following information: (a) the name and address of the taxpayer, (b) in the case of a corporation, the state of incorporation and the principal office or place of business, (c) the designation by date and symbol of the letter informing the taxpayer of the changes with respect to which the protest is made, (d) designation of the years involved and a statement of the amount of tax in dispute for each year, (e) an itemized schedule of the findings to which the taxpayer takes exception, (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception, (g) in case the taxpayer desires a hearing, a statement to that effect, (h) in case the protest is prepared or filed by an attorney or agent, a statement written on the document itself

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as an endorsement and signed by the attorney or agent, showing whether or not he prepared it and whether or not he knows of his own knowledge that the facts therein are true.

2053 (1) PENALTY AND INTEREST FOR FAILURE TO PAY TAX.

(a) **Five per cent penalty for late payment of tax.** In any case where a taxpayer fails to pay a tax imposed under the provisions of the Act, a penalty of five per cent of the unpaid tax shall be assessed as of the due date for payment of such tax, including interest on the amount of said tax and penalty.

If no part of the tax is paid on the original due date of the return, a penalty of five per cent of the entire tax liability shall be assessed. If the tax liability as shown on the return is paid in installments and the taxpayer fails to make payments of any installment on the date such installment becomes due, the entire remaining unpaid installments shall become due immediately and a penalty of five per cent of such unpaid tax shall be assessed.

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In a case where the Commissioner determines and assesses a deficiency tax and makes a demand for payment and such payment is not made within the thirty day period allowed after issuance of his final order, a penalty of five per cent of the entire additional tax remaining unpaid at the expiration of that period shall be assessed. In case an appeal is taken to the Board of Tax Appeals from such order, the five per cent penalty shall not be assessed unless the taxpayer fails to make payment within thirty days after final determination of such appeal.

If an extension of time to file a return or to pay the tax thereon is granted by the Commissioner and the tax is not paid as of the date of the expiration of such extension, a penalty of five per cent of the unpaid tax will be assessed.

The five per cent penalty imposed by M.S.A. 290.53 shall be collected as part of the tax.

The penalties herein provided apply to all assessments made after April 24, 1943.

With respect to the imposition of penalties in connection with members of the armed forces or civilians outside of the United States, see Regs. 2065 (1) through 2065 (8).

(b) **Assessment of interest for late payment of tax.** Interest at the rate of four per cent shall be assessed with respect to any unpaid tax imposed by this Act from the time such tax should have been paid until such tax is paid. If such tax is paid in installments and an installment becomes past due, interest shall accrue on the unpaid installments from the date prescribed for the payment of the installment until paid.

In the case where the Commissioner determines and assesses a deficiency tax and issues his final order demanding payment, interest at the rate of four per cent shall be assessed on the amount of the deficiency from the due date of the return to the date of the assessment and demand for payment. A thirty day period is allotted the taxpayer in which to pay such deficiency and interest without penalty or further interest. Upon the expiration of said thirty day period, interest will accrue until such time as the deficiency assessment is paid. If an appeal is taken from such deficiency assessment to the Board of Tax Appeals, interest will continue to accrue until such time as the deficiency assessment is either abated or paid.

If a penalty has been imposed under the provisions of M.S.A. 290.53, interest shall not only accrue with respect to the unpaid tax liability but it shall also accrue with respect to the penalty from the date the penalty became due until the penalty is paid.

Where an extension of time for payment has been granted by the Commissioner, interest must be paid at the rate of four per cent from the date such payment should have been made if no extension had been granted until such tax is actually paid.

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The rules herein stated apply to all assessments made after April 24, 1943. With respect to all assessments made on or after April 23, 1945, the rate of interest on unpaid taxes and deficiencies shall be four per cent per annum.

With respect to the assessment of interest in the case of a taxpayer who is in the military forces or who is a civilian outside of the United States, see Regs. 2065 (1) through 2065 (8).

(c) **Effect of extension of time for filing a return.** An extension of time for filing a return granted (other than to a corporation) under the provisions of M.S.A. 290.42 (5) has the effect of extending the time for payment of any tax which may be due. However, such extension only extends the due date of the installment which falls within the period extended.

Penalties and interest will apply in case the return is not filed and past due installments paid within the extended period, or if subsequent installments are not paid within the periods stated above.

If an extension of time for filing a return is granted, interest will accrue at four per cent per annum from the original due date to the date of payment. Thus, if a taxpayer procures a thirty day extension of time for filing and his return shows a tax liability of $400, interest will accrue for one month at four per cent per annum on $200, the amount of the first installment.

(d) **Effect of extension of time for payment.** Where a taxpayer files his return on or before the due date, but is granted an extension of time for payment of the tax or any installment thereof, no penalties will apply providing the installment is paid within the extended period.

However, interest shall be paid at four per cent per annum from the date when such payment should have been made if no extension had been granted until such tax or installment thereof is paid.

The rules herein stated apply to all assessments made after April 24, 1943. With respect to all assessments made on or after April 23, 1945, the rate of interest on unpaid taxes and deficiencies shall be four per cent per annum.

2053 (2) PENALTY FOR FAILURE TO MAKE AND FILE RETURN DUE TO WILFUL NEGLECT.

For taxable years beginning after December 31, 1946, the Act provides for a penalty for failure to file a return. This penalty is imposed unless it is shown that such failure to file was not due to wilful neglect. The negligence penalty is in lieu of the five per cent penalty for non-payment. The rate of penalty is five per cent of the tax if the failure to file is for not more than thirty days

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with an additional five per cent for each additional thirty days or fraction thereof during which the failure continues, not exceeding 25 per cent in the aggregate.

For taxable years beginning after December 31, 1964, in computing the penalty provided by M.S.A. 290.53, Subdivision 2, the varying penalty percentages are to be applied against the amount of tax required to be shown on the return reduced by (1) any part of such tax which was paid on or before the date prescribed for its payment and, (2) any credit against such tax which may be properly claimed on said return. Further with respect to such years, the amount so added as penalty plus any unpaid tax shall bear interest at four percent per annum.

2053 (6) ABATEMENT OF PENALTIES.

The Commissioner shall have power to abate penalties when in his opinion their enforcement would be unjust and inequitable. The exercise of this power shall be subject to the approval of the Attorney General.

Applications for abatement of penalities will be considered upon receipt of a sworn affidavit by the taxpayer setting forth the facts upon which such request for abatement is based.

2056 EXAMINATION OF BOOKS, RECORDS AND OTHER MEMORANDA.

Every person subject to the provisions of this Act, except persons whose gross income consists solely of salary, wages, or similar compensation for personal services rendered shall, for the purpose of enabling the Commissioner to determine the correct tax liability of such taxpayer under this Act, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income, and the deduction, credits, and other matters as are required to be shown in any return. Working papers reconciling gross income and deduction items, balance sheet items and surplus items set forth in the return with the trial balance of the ledger accounts shall be carefully preserved.

The taxpayer's retained copy of his return of income to the Federal Bureau of Internal Revenue for any year together with all amendments thereof or adjustments thereto shall be preserved, and be made available to examiners of the Income Tax Division.

Such books, records, work papers and Federal Income Tax returns shall be kept at all times available for inspection by Minnesota Income Tax Examiners, and shall be retained so long as the contents thereof may become material in the administration of this Act.

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In any case where the net income of a taxpayer as reported on his Federal income tax return is changed or corrected by the Internal Revenue Service, or where the taxpayer files an amended Federal income tax return or executes a consent to extend the time for the assessment of the taxes with the Internal Revenue Service, the taxpayer shall report such change or correction, the filing of such amended return or the execution of a consent to extend the time for the assessment of the taxes with the Internal Revenue Service by written notice directed to the Commissioner of Taxation within ninety days after whichever of the following events occur first:

(a) Notification from the Internal Revenue Service of a deficiency.

(b) Receipt of a Revenue Agent's Report.

(c) Payment of additional taxes.

(d) The execution of a consent to extend the time for the assessment of taxes with the Internal Revenue Service.

Failure to so notify the Commissioner of Taxation will extend the period within which the Commissioner may assess additional taxes for the taxable year involved for a period equal to the elapsed time between such final determination or the filing of an amended return or the execution of a consent to extend the time for the assessment of the taxes with the Internal Revenue Service and the date upon which proper notice is given to the Commissioner of Taxation or until six months following the expiration of the Federal period of limitation where no change is made or amended return is filed.

2057 COMMISSIONER TO APPOINT EXAMINERS.

The Commissioner may, at his discretion, appoint officers to be known as Income Tax Examiners whose duty it shall be to make such examination and determinations as are provided for in M.S.A. 290.56. These officers shall be furnished proper credentials signifying their appointment as above. The credentials shall be signed by the Commissioner and countersigned by the examiner.

It is the duty of every examiner to present his credentials to the taxpayer for the purpose of satisfying the taxpayer that he is duly authorized to examine the taxpayer's books, papers, records or memoranda relating to the return.

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2065 (2) MEMBERS OF ARMED FORCES OUTSIDE OF UNITED STATES.

(a) **Extension of the Statutes of Limitation for performing certain acts. (Not including assessment or collection of tax.)** In the case of members of the Armed Forces of the United States or of the United Nations, an automatic extension of time for filing returns, paying taxes, claiming refunds, commencing action thereon, appealing to the Board of Tax Appeals and appealing to the Supreme Court, concerning income taxes, is granted until the expiration of six months after return to the United States, if such individuals have been outside of the continental United States continuously for a period of more than ninety days after December 7, 1941. This extension of time for performing the various acts above mentioned is automatic. It is unnecessary to make a request for such extension in advance of the due date for performing any of the acts above mentioned.

Upon return to the United States a member of the Armed Forces will qualify under Reg. 2065 (4). Reference should, therefore, be made to that regulation in determining the extension of the period of limitations which is granted in such case.

(b) **Interest and penalties.** No interest shall be assessed or collected from any member of the Armed Forces of the United States or of the United Nations for the period during which the extension of time for performing the acts as set forth in paragraph (a) of this regulation is granted.

Any interest which may have accrued prior to the period of extension is not waived. Interest will accrue, however, for any part of that period an individual is not a member of the Armed Forces of the United States or United Nations. If penalties or interest were incurred by members of the Armed Forces prior or subsequent to the period for which the extension was granted, a request may be filed with the Commissioner of Taxation for the abatement of such penalties and interest. This request should be in affidavit form and should set forth the reason why the imposition of penalties or interest would be unjust and inequitable.

It should be remembered that the moment a member of the Armed Forces returns to the continental United States he automatically comes within the provisions of Reg. 2065 (4) as he is then a member of the Armed Forces within the United States. In that situation, no interest will be assessed until six months after termination of his services with the Armed Forces even though for the last six months he was not a member of the Armed Forces.

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No interest is payable with respect to refunds for the period during which the extension of time for performing the acts is granted under paragraph (a) of this regulation irrespective of whether such individual is a member of the Armed Forces for such entire period or not.

No penalty will be assessed against or collected from any individual because of the failure to perform any of the acts set forth in paragraph (a) of this regulation during the extension of the periods of limitation as set forth in such paragraph.

(c) **Appointment of administrator, executor, or guardian.** Where an administrator, executor or guardian is appointed in this State with respect to any member of the Armed Forces outside of the continental United States, the extension of time for performing the acts mentioned in paragraphs (a) and (b) of this regulation are not extended beyond the period provided in the Income Tax Act for more than three months after such appointment. This does not apply to the period within which the assessment of tax may be made.

(d) **Extension of time for assessment and collection of tax.** The time within which the assessment of any tax, penalty, or interest is extended, with respect to members of the Armed Forces outside of the United States, is six months after the period set forth in paragraph (a) of this regulation. The time for commencement of action to collect such tax is extended for an additional six months period after the expiration of the period for assessment. The statute of limitations mentioned under this regulation does not begin to run until a written notice of return to the United States is filed with the Commissioner of Taxation. As an illustration, assume that a taxpayer filed a notice with the Commissioner of Taxation on January 1, 1944, notifying the Commissioner that he has returned to the United States. The period for assessment of tax is extended until six months after the expiration of the six month period after return to the United States and will not expire until the following January 1, 1945. The time within which suit for collection may be commenced is extended until six months thereafter or until July 1, 1945.

2065 (3) CIVILIANS OUTSIDE OF UNITED STATES.

(a) **Extension of time for performing certain acts. (Not including assessment or collection of tax.)** An automatic extension of time with respect to civilians who are outside the continental United States is granted with respect to the same acts and for the same period of time as described in paragraph (a) of Reg. 2065 (2), for which an extension is granted members of the military forces outside the United States. An extension of time is, therefore, automatically granted until six months after return to the continental United States.

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(b) **Interest and penalties.** Interest accrues during the entire period for which the automatic extension is granted under paragraph (a) of this regulation, except for any part of the period of that extension during which an individual may be a member of the Armed Forces of the United States or of the United Nations. The period for the assessment or collection of such interest is suspended until six months after return to the continental United States. No interest is payable for the period during which the extension is granted under paragraph (a) of this regulation with respect to refunds.

No penalties will be assessed against, or collected from, any civilian outside of the United States by reason of failure to perform the acts during the period for which an extension of time for performance thereof is granted under paragraph (a) of this regulation.

If the imposition of the interest would be unjust or inequitable, an affidavit may be filed with the Commissioner of Taxation requesting the abatement of interest. This request should be in affidavit form and should set forth the reason why the imposition of interest would be unjust and inequitable.

(c) **Appointment of an administrator, executor or guardian.** Where an administrator, executor, or guardian is appointed in this State for a civilian outside of the continental United States, the extension of time for performing the acts described under paragraphs (a) and (b) of this regulation is not extended for more than three months after such appointment irrespective of the extension of time set forth in paragraphs (a) and (b) of this regulation. This does not apply to the period within which the assessment of tax may be made.

(d) **Extension of time for assessment and collection of tax.** The time within which assessment of tax, penalty, or interest is extended, with respect to civilians outside of the United States, is for the same period as provided in paragraph (a) of this regulation and in addition for a further period of six months. The time for commencement of action to collect such tax is extended for an additional six months after the expiration of the period within which an assessment may be made. The periods mentioned herein do not begin to run until a written notice of return to the United States is filed with the Commissioner of Taxation.

2065 (4) MEMBERS OF ARMED FORCES WITHIN UNITED STATES.

(a) **Extension of time for performing certain acts. (Not including assessment of tax.)** An extension of time to file returns, pay taxes, claim refunds, commence action thereon, appeal to the Board of Tax Appeals and to the Supreme Court in matters relating to income taxes is granted to all members serving con-

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tinuously in the Armed Forces of the United States for any period beginning after December 7, 1941, and for a further period of six months after the termination of such services provided such individual's ability to perform such acts is materially impaired by reason of such services. This extension is automatic and no request need be made therefor unless the Commissioner requests a signed statement or affidavit of proof that an individual's ability is so impaired.

This provision is directly related with the provisions of paragraph (a) of Reg. 2065 (2). A member of the Armed Forces automatically comes under the provisions of either that regulation or this regulation upon his leaving or re-entering the United States.

(b) **Interest and penalty.** No interest or penalty will be assessed or collected, with respect to the period during which the time for performing acts set forth in paragraph (a) of this regulation, is extended. This period of extension does not expire until the expiration of six months after termination of services in the Military Forces regardless of the fact that such individual is not actually a member of the Armed Forces for the last six months thereof. Any penalty or interest which accrued prior to this period is not abated, but the time for assessment or collection thereof is suspended until the expiration of the period for which such extension is granted.

No interest will be paid upon any income tax refund to any individual with respect to whom and for the period during which the statutes of limitations are extended under paragraph (a) of Reg. 2065 (2).

However, if penalties or interest were incurred by members of the Armed Forces either prior or subsequent to the period for which the extension of time was granted, a request may be filed with the Commissioner of Taxation for the abatement of such penalties or interest. This request should be in affidavit form and should set forth the reasons why the imposition of such penalties or interest would be unjust and inequitable.

(c) **Appointment of administrator, executor, or guardian.** The period for performing the acts described in paragraphs (a) and (b) of this regulation shall not be extended for more than three months after the appointment of an administrator, executor or guardian in this State irrespective of the extensions of time granted under paragraph (a) of this regulation. This does not apply to the period within which the assessment of a tax may be made.

(d) **Extension of time for assessment and collection of tax.** The time for assessment of tax, penalty, or interest is extended until six months after termination of military services and for a further period of six months after such termination. Collection

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of such tax, interest, or penalty is extended for an additional six months after the expiration of the period for assessment. The period of limitations does not begin to run until a written notice of such termination is filed with the Commissioner.

2065 (5) CIVILIANS WITHIN UNITED STATES.

A civilian within the United States is required to make a written request for an extension of time to file returns and pay taxes in accordance with the provisions of the Income Tax Act under M.S.A. 290.42, Reg. 2042 (5) and M.S.A. 290.45, Subd. 2, Reg. 2045 (2). With respect to other acts required to be performed under the Income Tax Act, request must be made in accordance with the relative provisions of the law.

2065 (8) DEATH OF MEMBER OF ARMED FORCES.

If an individual dies on or after December 7, 1941, while in active service as a member of the military or naval forces of the United States or of any of the United Nations prior to the termination of hostilities as proclaimed by Congress or by the President of the United States (December 31, 1946, 12 o'clock noon), the following rules shall apply with respect to taxes unpaid at the date of death:

1. The tax for the year in which falls the date of death shall not be assessed.

2. The unpaid tax for any prior year or years shall be cancelled.

If the decedent had paid a tax for any taxable year after December 31, 1940, during which he was in active service, a claim for refund may be filed and the entire tax paid for such year may be refunded. The claim for refund must be filed within seven years after December 31, 1946, 12 o'clock noon. A certified copy of the notice of death or other official notification of his death should be attached to the claim for refund. This claim may be filed by the executor or administrator of the estate or if there be no estate by the person entitled to such refund.

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If an individual dies on or after December 31, 1949, while in active service as a member of the military or naval forces of the United States or of any of the United Nations, the following rules shall apply with respect to taxes unpaid at the date of death:

1. The tax for the year in which falls the date of death shall not be assessed.

2. The unpaid tax for any prior year or years shall be cancelled.

If the decedent had paid a tax for any taxable year beginning after December 31, 1949, during which he was in active service, a claim for refund may be filed and the entire tax paid for such year may be refunded. The claim for refund must be filed within seven years after the date on which the return for that taxable year was filed. A certified copy of the notice of death or other official notification of his death should be attached to the claim for refund. This claim may be filed by the executor or administrator of the estate or if there be no estate by the person entitled to such refund.

2092 (1)-2 PAYROLL PERIOD

(A) The term "payroll period" means the period of service for which a payment of wages is ordinarily made to an employee by his employer. It is immaterial that the wages are not always paid at regular intervals. For example, if an employer ordinarily pays a particular employee for each calendar week at the end of the week, but if for some reason the employee in a given week receives a payment in the middle of the week for the portion of the week already elapsed and receives the remainder at the end

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of the week, the payroll period is still the calendar week; or if, instead, that employee is sent on a 3-week trip by his employer and receives at the end of the trip a single wage payment for three weeks' services, the payroll period is still the calendar week, and the wage payment shall be treated as though it were three separate weekly wage payments.

(B) For the purpose of M.S.A. 290.92, an employee can have but one payroll period with respect to wages paid by any one employer. Thus, if an employee is paid a regular wage for a weekly payroll period and in addition thereto is paid supplemental wages (for example, bonuses) determined with respect to a different period, the payroll period is the weekly payroll period.

(C) The term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual, or annual payroll period.

2092 (1)-3 EMPLOYEE

(A) The term "employee" includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. The term includes officers and employees, whether elected or appointed, of the United States, a State, Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing.

(B) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

(C) Generally, physicians, lawyers, dentists, veterinarians, contractors, subcontractors, public stenographers, auctioneers,

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and others who follow an independent trade, business, or profession, in which they offer their services to the public, are not employees.

(D) Whether the relationship of employer and employee exists will in doubtful cases be determined upon an examination of the particular facts of each case.

(E) If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.

(F) All classes or grades of employees are included within the relationship of employer and employee. Thus, superintendents, managers, and other supervisory personnel are employees. Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is not considered to be an employee of the corporation. A director of a corporation in his capacity as such is not an employee of the corporation.

(G) Although an individual may be an employee under this section, his services may be of such a nature, or performed under such circumstances, that the remuneration paid for such services does not constitute wages within the meaning of M.S.A. 290.92, Subd. 1.

2092 (1)-4 EMPLOYER

(A) The term "employer" means any person for whom an individual performs or performed any service, of whatever nature, as the employee of such person.

(B) It is not necessary that the services be continuing at the time the wages are paid in order that the status of employer exist. Thus, for purposes of withholding, a person for whom an individual has performed past services for which he is still receiving wages from such person is an "employer".

(C) An employer may be an individual, a corporation, a partnership, a trust, an estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity. A trust or estate, rather than the fiduciary acting for or on behalf of the trust or estate, is generally the employer.

(D) The term "employer" embraces not only individuals and organizations engaged in trade or business, but organizations

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exempt from income tax, such as religious and charitable organizations, educational institutions, clubs, social organizations and societies, as well as the governments of the United States, the States, Territories, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions.

(E) If the person for whom the services are or were performed does not have legal control of the payment of wages for such services, the term "employer" means (except for the purpose of the definition of "wages") the person having such control. For example, where wages, such as certain types of pensions or retired pay, are paid by a trust and the person for whom the services were performed has no legal control over the payment of such wages, the trust is the "employer".

(F) It is a basic purpose to centralize in the employer the responsibility for withholding, returning, and paying the tax, and for furnishing the statements required under M.S.A. 290.92. The special definition of the term "employer" in paragraph (E) is designed solely to meet unusual situations. It is not intended as a departure from the basic purpose.

2092 (2)-1 REQUIREMENT OF WITHHOLDING

(A) M.S.A. 290.92, Subd. 2 provides alternative methods, at the election of the employer, for use in computing the income tax to be collected at source on wages. Under the wage bracket method (see M.S.A. 290.92, Subd. 2 (3)) the employer is required to deduct and withhold a tax in accordance with the tables prepared by the commissioner. The commissioner may authorize under the provisions of M.S.A. 290.92, Subd. 2 (7), the employer to withhold the tax on the basis of the employee's average

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estimated wages with necessary adjustments for any quarter. Before using this method the employer must receive authorization from the commissioner. Applications to use such method must be accompanied by evidence establishing the need for such method.

(B) The employer is required to collect the tax by deducting and withholding the amount thereof from the employee's wages as and when paid, either actually or constructively. Wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case, the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that they may be drawn upon at any time, and their payment brought within his own control and disposition.

(C) An employer is required to deduct and withhold the tax notwithstanding the wages are paid in something other than money (for example, wages paid in stocks or bonds) and to pay over the tax in money. If the wages are paid in property other than money, the employer should make necessary arrangements to insure that the amount of the tax required to be withheld is available for payment in money.

(D) As a matter of business administration, certain of the mechanical details of the withholding process may be handled by representatives of the employer. Thus, in the case of an employer having branch offices, the branch manager or other representative may actually as a matter of internal administration, withhold the tax or prepare the statements required. Nevertheless, the legal responsibility for withholding, paying, and returning the tax and furnishing such statements rests with the employer.

(E) The amount of any tax withheld and collected by the employer is a special fund in trust for the State of Minnesota.

2092 (2)-2 WAGE BRACKET WITHHOLDING

(A) The employer may elect to use the wage bracket method provided in M.S.A. 290.92, Subd. 2 (3) with respect to any employee. The tax computed under the wage bracket method shall be the tax required to be deducted and withheld under M.S.A. 290.92. Wage bracket withholding tables for weekly, semimonthly, monthly, and daily or miscellaneous payroll periods have been prepared by the commissioner and are available for distribution in a separate publication.

(B) Established Payroll Periods, Other Than Daily Or Miscellaneous, Covered By Wage Bracket Withholding Tables. The

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wage bracket withholding tables referred to above for established payroll periods other than daily or miscellaneous should be used in determining the tax to be withheld for any such period without reference to the time the employee is actually engaged in the performance of services during such payroll period.

(C) Periods To Which The Table For A Daily Or Miscellaneous Payroll Period Is Applicable (1) In general. The table applicable to a daily or miscellaneous payroll period shows the tax on the amount of wages for one day. Where the withholding is computed under the rules applicable to a miscellaneous payroll period, the wages and the amounts shown in the table must be placed on a comparable basis. This may be accomplished by reducing the wages paid for the period to a daily basis by dividing the total wages by the number of days (including Sundays and holidays) in the period. The amount of the tax shown in the table as the tax required to be withheld from the wages, as so reduced to a daily basis, should then be multiplied by the number of days (including Sundays and holidays) in the period.

(2) Period Not A Payroll Period. If wages are paid for a period which is not a payroll period, the amount to be deducted and withheld under the wage bracket method shall be the amount applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days (including Sundays and holidays) in the period with respect to which such wages are paid.

(3) Wages Paid Without Regard To Any Period. If wages are paid to an employee without regard to any particular period, as, for example, commissions paid to a salesman upon consummation of a sale, the amount of tax to be deducted and withheld shall be determined in the same manner as in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days (including Sundays and holidays) which have elapsed, beginning with the latest of the following days:

(i) the first day after the last payment of wages to such employee by such employer in the calendar year, or

(ii) the date on which such individual's employment with such employer began in the calendar year, or

(iii) January 1 of such calendar year, and ending with (and including the date on which such wages are paid.

(D) Period Or Elapsed Time Less Than One Week. (1) It is the general rule that if wages are paid for a payroll period or other period of less than one week, the tax to be deducted and withheld under the wage bracket method shall be the amount computed for a daily payroll period, or for a miscellaneous payroll period containing the same number of days (including Sun-

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days and holidays) as the payroll period, or other period, for which such wages are paid. In the case of wages paid without regard to any period, if the elapsed time computed as provided in paragraph (C) of this section is less than 1 week, the same rule is applicable.

(E) Rounding Off Of Wage Payment. In determining the amount to be deducted and withheld under the wage bracket method the wages may, at the election of the employer, be computed to the nearest dollar, provided such wages are in excess of the highest wage bracket of the applicable table. For the purpose of the computation to the nearest dollar, the payment of a fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or more, in which case it shall be increased to $1.00.

2092 (2)-3 ADDITIONAL WITHHOLDING

(A) In addition to the tax required to be deducted and withheld in accordance with the provisions of M.S.A. 290.92, the employer and employee may agree that an additional amount shall be withheld from the employee's wages.

(B) The amount deducted and withheld pursuant to an agreement between the employer and employee shall be considered as tax required to be deducted and withheld under M.S.A. 290.92. All provisions of law and regulations applicable with respect to the tax required to be deducted and withheld under M.S.A. 290.92 shall be applicable with respect to any amount deducted and withheld pursuant to the agreement.

2092 (3)-1 SUPPLEMENTAL WAGE PAYMENTS

(A) In general. (1) An employee's remuneration may consist of wages paid for a payroll period and supplemental wages, such as bonuses, commissions, and overtime pay, paid for the same or a different period, or without regard to a particular period. When such supplemental wages are paid (whether or not at the same time as the regular wages) the amount of the tax required to be withheld shall be determined in accordance with this paragraph or paragraph (B).

(2) The supplemental wages, if paid concurrently with wages for a payroll period, shall be aggregated with the wages paid for such payroll period. If not paid concurrently, the supplemental wages shall be aggregated with the wages paid or to be paid within the same calendar year for the last preceding payroll period or for the current payroll period. The amount of tax to be withheld shall be determined as if the aggregate of the supplemental wages and the regular wages constituted a single wage payment for the regular payroll period.

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(3) In cases where supplemental wages are not paid concurrently with wages for a payroll period the employer may determine the amount of tax required to be withheld in accordance with this paragraph rather than in accordance with the provisions of paragraph (2) above. In such a case the withholding of tax on such supplemental payments shall be at the rate of four percent as if no exemption had been claimed.

(B) Special Rule Where Aggregate Withholding Exemption Exceeds Wages Paid. (1) If supplemental wages are paid to an employee during a calendar year for a period which involves two or more consecutive payroll periods, for which other wages also are paid during such calendar year, and the aggregate of such other wages is less than the aggregate of the amounts determined under the table furnished by the commissioner as the withholding exemptions applicable for such payroll periods, the amount of the tax required to be withheld on the supplemental wages shall be computed as follows:

Step 1. Determine an average wage for each of such payroll periods by dividing the sum of the supplemental wages and the wages paid for such payroll periods by the number of such payroll periods.

Step 2. Determine a tax for each payroll period as if the amount of the average wage constituted the wages paid for such payroll period.

Step 3. From the sum of the amounts of tax determined in Step 2 subtract the total amount of tax withheld, or to be withheld, from the wages, other than the supplemental wages, for such payroll periods. The remainder, if any, shall constitute the amount of the tax to be withheld upon the supplemental wages.

(2) The rules prescribed in this paragraph shall, at the election of the employer, be applied in lieu of the rules prescribed in paragraph (A) of this section except that this paragraph shall not be applicable in any case in which the payroll period of the employee is less than one week.

(C) Vacation Allowances. Amounts of so-called "vacation allowances" shall be subject to withholding as though they were regular wage payments made for the period covered by the vacation. If the vacation allowance is paid in addition to the regular wage payment for such period, the rules applicable with respect to supplemental wage payments shall apply to such vacation allowance.

2092 (3)-2 WAGES PAID FOR PAYROLL PERIOD OF MORE THAN ONE YEAR

If wages are paid to an employee for a payroll period of more than one year, for the purpose of determining the amount of

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tax required to be deducted and withheld in respect of such wages —

The amount of the tax shall be determined as if such payroll period constituted a miscellaneous payroll period of 365 days.

2092 (3)-3 WAGES PAID THROUGH AN AGENT, FIDUCIARY, OR OTHER PERSON ON BEHALF OF TWO OR MORE EMPLOYERS

(A) If a payment of wages is made to an employee by an employer through an agent, fiduciary, or other person who also has control, receipt, custody, or disposal of, or pays the wages payable by another employer to such employee, the amount of tax required to be withheld on each wage payment made through such agent, fiduciary or person shall, whether the wages are paid separately on behalf of each employer or paid in a lump sum on behalf of all such employers, be determined upon the aggregate amount of such wage payment or payments in the same manner as if such aggregate amount had been paid by one employer.

(B) In any such case, each employer shall be liable for the return and payment of a pro-rata portion of the tax so determined, such portion to be determined in the ratio which the amount contributed by the particular employer bears to the aggregate of such wages.

(C) For example, three companies maintain a central management agency which carries on the administrative work of the several companies. The central agency organization consists of a staff of clerks, bookkeepers, stenographers, etc., who are the common employees of the three companies. The expenses of the central agency, including wages paid to the foregoing employees, are borne by the several companies in certain agreed proportions. Company X pays 45 percent, Company Y pays 35 percent and Company Z pays 20 percent of such expenses. The amount of the tax required to be withheld on the wages paid to persons employed in the central agency should be determined in accordance with the provisions of this section. In such event, Company X is liable as an employer for the return and payment of 45 percent of the tax required to be withheld. Company Y is liable for the return and payment of 35 percent of the tax and Company Z is liable for the return and payment of 20 percent of the tax.

2092 (4) INCLUDED AND EXCLUDED WAGES

(A) If a portion of the remuneration paid by an employer to his employee for services performed during a payroll period of not more than 31 consecutive days constitutes wages, and the remainder does not constitute wages, all the remuneration paid the employee for services performed during such period shall for

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purposes of withholding be treated alike, that is, either all included as wages or all excluded. The time during which the employee performs services, the remuneration for which under M.S.A. 290.92, Subd. 1 (a) constitutes wages, and the time during which he performs services, the remuneration for which under such section does not constitute wages, determine whether all the remuneration for services performed during the payroll period shall be deemed to be included or excluded.

(B) If one-half or more of the employee's time in the employ of a particular employer in a payroll period is spent in performing services the remuneration for which constitutes wages, then all the remuneration paid the employee for services performed in that payroll period shall be deemed to be wages.

(C) If less than one-half of the employee's time in the employ of a particular employer in a payroll period is spent in performing services the remuneration for which constitutes wages, then none of the remuneration paid the employee for services performed in that payroll period shall be deemed to be wages.

(D) The rules set forth in this section do not apply (1) with respect to any remuneration paid for services performed by an employee for his employer if the periods for which remuneration is paid by the employer vary to the extent that there is no period which constitutes a payroll period within the meaning of M.S.A. 290.92, Subd. 1 (2) with respect to any remuneration paid for services performed by an employee for his employer if the payroll period for which remuneration is paid exceeds 31 consecutive days. In any such case withholding is required with respect to that portion of such remuneration which constitutes wages.

2092 (4a) WITHHOLDING ON PERSONAL SERVICE COMPENSATION OF CERTAIN NONRESIDENTS

(1) Relation To Other Withholding Provisions. Notwithstanding any of the provisions of M.S.A. 290.92, the terms employee, employer and wages for purposes of M.S.A. 290.92 shall be as defined in this regulation.

(2) Professional Athletes And Entertainers. The term employee under this article means any nonresident who earns compensation for personal services performed in Minnesota in connection with sporting events or in connection with the preparation or presentation of entertainment, whether as a participant, performer or otherwise. As used in this article, a nonresident earning compensation for personal services in connection with a sporting event, in addition to the actual participants, shall include, but shall not be limited to, referees, trainers and jockey agents. As used in this article, a nonresident earning compensation for personal services in connection with the preparation

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or presentation of entertainment shall include, but shall not be limited to, actors, singers, musicians, dancers, circus performers, writers, directors, set designers and any person appearing on television or radio, the stage, in a night club performance or hotel show and any person whose performance is recorded or filmed. The term employee also includes any nonresident earning personal service compensation in the form of a prize or award paid in cash or securities.

(3) Pay Received By Athletes, Etc. Compensation so earned by such nonresident is considered wages subject to the withholding provisions of M.S.A. 290.92.

(4) Employers. The term employer under this article means any individual, corporation, association or partnership or any agent thereof, the United States, a state, territory or any political subdivision thereof or any agency or instrumentality thereof or any officer, employee or agent thereof maintaining an office or transacting business within the State who has control, receipt, custody, disposal or payment of compensation taxable under Chapter 290 and earned by a nonresident in the manner described above.

(5) State Athletic Commission Licensee. In the case of one earning compensation for personal services performed in connection with the conduct of a boxing, sparring or wrestling match or exhibition, either as a boxer, wrestler or otherwise, his employer, for purposes of withholding shall be the licensee licensed by the Minnesota State Athletic Commission to conduct the boxing, sparring or wrestling match or exhibition in connection with which the boxer, wrestler or other employee under this article is being compensated.

(6) Payor, Manager Or Agent. In the case of one earning compensation for personal services in connection with any other type of sporting event or earning compensation for personal services in connection with the preparation or presentation of entertainment, generally, his employer for purposes of withholding shall be the person paying him.

(7) Award Or Prize. In the case of a winner of a taxable award or prize, generally, his employer for the purposes of withholding shall be the person paying the prize or award to him or his agent.

(8) Employee To File Certificate Before Performance. Each person, whether a resident or nonresident on or before the date he commences performing personal services of the type described above, shall file with his employer, as defined in this regulation, an exemption certificate stating whether or not he is a resident and, if a resident, also stating the number of withholding exemptions to which he is entitled. If a person fails to furnish such

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certificate, he shall be considered as claiming no withholding exemptions and for the purposes of this regulation, a nonresident subject to withholding.

(9) Withholding Rates. Withholding shall be in the manner and at the rates provided in M.S.A. 290.92.

(10) Deductible Expenses. If an employee wishes his employer, in computing the amount subject to withholding, to allow for ordinary and necessary expenses spent or reasonably expected to be spent in earning his personal service compensation, he shall submit to his employer an itemized, signed and dated statement of his ordinary and necessary expenses. The employer may allow the amount claimed where the expenses are bona fide and are not in excess of 50% of the amount to be paid.

(11) Employer's Receipt. Every employer required to deduct and withhold from an employee a tax under this regulation or who would have been required to deduct and withhold if the employee had claimed no more than one withholding exemption is required to furnish to each such employee within thirty days after the last payment of compensation for personal services for a period of employment, or by the 31st day of January following the close of the calendar year, whichever is earlier, a statement showing the amount of total wages paid by the employer to the employee during that period of employment, the amount deducted and withheld as tax and such other information as is required on that form. If the employee is later rehired by the same employer during the calendar year, a separate withholding statement must be furnished to the employee separately covering that period of employment.

(12) Employer's Returns. An employer shall include the tax withheld under this regulation in his monthly deposits and in his quarterly return required under the provisions of M.S.A. 290.92.

2092 (5) -1 WITHHOLDING EXEMPTIONS

(A) In general. (1) An employee receiving wages shall on any day be entitled to withholding exemptions as provided in M.S.A. 290.92, Subd. 5. (1). In order to receive the benefit of such exemptions, the employee must file with his employer a withholding exemption certificate as provided in M.S.A. 290.92, Subd. 5 (2). See 2092 (5) (A) (2).

(2) The number of exemptions to which an employee is entitled on any day depends on his status as single or married, upon his status as to old age and blindness, upon the number of his dependents, and, if married, upon the number of exemptions claimed by his spouse.

(B) Withholding Exemptions To Which An Employee Is Entitled In Respect Of Himself. An employee is entitled to one

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withholding exemption for himself. An employee shall on any day be entitled to an additional withholding exemption for himself if he will have attained the age of 65 before the close of his taxable year which begins in, or with, the calendar year in which such day falls. If the employee is blind, he may claim an additional withholding exemption for blindness. For purposes of claiming a withholding exemption for blindness, an individual shall be considered blind only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses or if his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees. For definition of the term "blindness", see M.S.A. 290.06, Subd. 3 (4) (d).

(C) Withholding Exemption To Which An Employee Is Entitled In Respect Of His Spouse. (1) A married employee, whose spouse is an employee receiving wages, is entitled to claim any withholding exemption to which his spouse is entitled under paragraph (B) of this section, unless the spouse has in effect a withholding exemption certificate claiming such withholding exemption. A married employee, whose spouse is not an employee receiving wages, is entitled to claim any withholding exemption to which his spouse would be entitled under paragraph (B) of this section if the spouse were an employee receiving wages.

Example (1). Assume that both the husband and wife have attained the age of 65 and are employees receiving wages. Each spouse is entitled under paragraph (B) of this section to claim 2 withholding exemptions in respect of himself or herself. Either spouse may claim, in addition to the withholding exemptions to which he or she is entitled in respect of himself or herself, any withholding exemption to which the other spouse is entitled under such paragraph (B) but does not claim on a withholding exemption certificate.

Example (2). Assume the same facts as in Example (1) except that only the husband is an employee receiving wages. The husband is entitled to claim 4 withholding exemptions, that is, the 2 withholding exemptions to which he is entitled in respect of himself and the 2 withholding exemptions to which his spouse would be entitled under paragraph (B) of this section if she were an employee receiving wages.

(2) In determining the number of withholding exemptions to which an employee is entitled for himself and his spouse on any day, the employee's status as a single person or a married person and, if married, whether a withholding exemption is claimed by his spouse shall be determined as of such day. However, in the case of an employee whose spouse dies in the taxable year of the employee which begins in, or with, the calendar year in which the spouse dies, any withholding exemption which

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would be allowable to the employee in respect of such spouse, if living and not an employee receiving wages, may be claimed by the employee for that portion of the calendar year which occurs after his spouse's death. For provisions applicable in the case of an employee whose taxable year is not a calendar year, and whose spouse dies in that portion of the calendar year which precedes the first day of the taxable year of the employee which begins in the calendar year, see 2092 (5)-2 (B).

(D) Withholding Exemptions To Which An Employee Is Entitled In Respect Of Dependents. Subject to the limitations stated in this paragraph, an employee shall be entitled on any day to a withholding exemption for each individual who may reasonably be expected to be his dependent for his taxable year beginning in, or with, the calendar year in which such day falls. For purposes of the withholding exemption for an individual who may reasonably be expected to be a dependent, the following rules shall apply:

(1) The determination that an individual may or may not reasonably be expected to be a dependent shall be made on the basis of facts existing at the beginning of the day for which a withholding exemption for such individual is to be claimed. The individual in respect of whom an exemption is claimed by an employee must, on the day in question, be in existence and be a "dependent". However, a withholding exemption for a dependent who dies continues for the portion of the calendar year which occurs after the dependent's death, except that, in the case of an employee whose taxable year is not a calendar year, the withholding exemption does not continue for a dependent whose death occurs before the first day of the employee's taxable year beginning in the calendar year of death.

(2) The determination that an individual may or may not reasonably be expected to be a dependent shall be made for the taxable year of the employee in respect of which amounts deducted and withheld in the calendar year in which the day in question falls are allowed as a credit. In general, amounts deducted and withheld during any calendar year are allowed as a credit against the tax imposed by chapter 290 for the taxable year which begins in, or with, such calendar year. Thus, in order for an employee to be able to claim for a calendar year a withholding exemption with respect to a particular individual as a dependent there must be a reasonable expectation that the employee will be allowed a credit with respect to such individual under M.S.A. 290.06, Subd. 3 (4) (c) for his taxable year which begins in, or with, such calendar year.

(3) For the employee to be entitled on any day of the calendar year to a withholding exemption for an individual as a dependent, such individual must on such day—

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(i) Be an individual referred to in M.S.A. 290.06, Subd. 3 (4) (c).

(ii) Reasonably be expected to receive over one-half of his support from the employee in the calendar year.

2092 (5)-2 WITHHOLDING EXEMPTION CERTIFICATES

(A) On Commencement Of Employment. On or before the date on which an individual commences employment with an employer, the individual shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled; however, if any employee (except those coming within the provisions of 2092 (4a)) has filed with such employer the Federal form W-4 the employer may use such Federal exemption form for purposes of withholding under the State statute unless the employee elects to file a Minnesota withholding exemption certificate. If an employee fails to furnish either a Federal or a Minnesota State withholding exemption certificate, the employer is required to withhold tax as if the employee had claimed no withholding exemptions.

(B) Change In Exemptions Which Affects Calendar Year. (1) If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by him on the withholding exemption certificate then in effect, the employee must within 10 days after the change occurs furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which must in no event exceed the number to which he is entitled on such day. The number of withholding exemptions to which an employee is entitled decreases, for example, for any one of the following reasons:

(i) The employee's wife (or husband) for whom the employee has been claiming a withholding exemption (a) is divorced or legally separated from the employee, or (b) claims her (or his) own withholding exemption on a separate certificate.

(ii) In the case of an employee whose taxable year is not a calendar year, the employee's wife (or husband) for whom the employee has been claiming a withholding exemption dies in that portion of the calendar year which precedes the first day of the taxable year of the employee which begins in the calendar year in which the spouse dies.

(iii) The employee finds that no exemption for his taxable year which begins in, or with, the current calendar year will be

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allowable to him under M.S.A. 290.06, Subd. 3 (4) (c) in respect of an individual claimed as a dependent on the employee's withholding exemption certificate.

(2) If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is more than the number of withholding exemptions claimed by him on the withholding exemption certificate then in effect, the employee may furnish the employer with a new withholding exemption certificate on which the employee must in no event claim more than the number of withholding exemptions to which he is entitled on such day.

(C) *Change In Exemption Which Affects Next Calendar Year.* (1) If, on any day during the calendar year, the number of exemptions to which the employee will be or may reasonably be expected to be, entitled under M.S.A. 290.06, Subd. 3 (4) (c) for his taxable year which begins in, or with, the next calendar year is different from the number to which the employee is entitled on such day, the following rules shall be applicable.

(i) If such number is less than the number of withholding exemptions claimed by the employee on a withholding exemption certificate in effect on such day, the employee must, on or before December 1 of the year in which the change occurs, unless such change occurs in December, furnish his employer with a new withholding exemption certificate reflecting the decrease in the number of withholding exemptions. If the change occurs in December, the new certificate must be furnished within 10 days after the change occurs. The number of exemptions to which an employee is entitled for his taxable year which begins in, or with, the next calendar year decreases, for example, for any of the following reasons:

(a) The spouse or a dependent of the employee dies.

(b) The employee finds that it is not reasonable to expect that an individual claimed as a dependent on the employee's withholding exemption certificate will qualify as a dependent of the employee for such taxable year.

(ii) If such number is greater than the number of withholding exemptions claimed by the employee on a withholding exemption certificate in effect on such day, the employee, may on or before December 1 of the year in which such change occurs, unless such change occurs in December, furnish his employer with a new withholding exemption certificate reflecting the increase in the number of withholding exemptions. If the change occurs in December, the certificate may be furnished on or after the date on which the change occurs.

(2) Before December 1 of each year, every employer should request each of his employees to file a new withholding exemp-

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tion certificate for the ensuing calendar year, in the event of change in the employee's exemption status since the filing of his latest certificate.

2092 (5)-3 WHEN WITHHOLDING EXEMPTION CERTIFICATE TAKES EFFECT

(A) A withholding exemption certificate furnished to the employer in any case in which no previous withholding exemption certificate is in effect with such employer, shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is furnished.

(B) A withholding exemption certificate furnished the employer in any case in which a previous withholding exemption certificate is in effect with such employer shall, except as hereinafter provided, take effect with respect to the first payment of wages made on or after the first status determination date which occurs at least 30 days after the date on which such certificate is so furnished. However, at the election of the employer, except as hereinafter provided, such certificate may be made effective with respect to any payment of wages made on or after the date on which such certificate is so furnished and before such status determination date.

(C) A withholding exemption certificate furnished the employer pursuant to M.S.A. 290.92 which effects a change for the next calendar year, shall not take effect, and may not be made effective, with respect to the calendar year in which the certificate is furnished.

(D) For purposes of this section the term "status determination date" means January 1 and July 1 of each year.

2092 (5)-4 PERIOD DURING WHICH WITHHOLDING EXEMPTION CERTIFICATE REMAINS IN EFFECT

A withholding exemption certificate which takes effect under M.S.A. 290.92, Subd. 5 (4) shall continue in effect with respect to the employee until another withholding exemption certificate takes effect under M.S.A. 290.92, Subd. 5 (4).

2092 (6) FAILURE TO WITHHOLD

If the employer in violation of the provisions of M.S.A. 290.92, Subd. 6 (7) (b) fails to deduct and withhold the tax, and thereafter the income tax against which the tax under Subd. 6 (7) (b) may be credited is paid, the tax under Subd. 6 (7) (b) shall not be collected from the employer. Such payment does not, however, operate to relieve the employer from liability for penalties or additions to the tax applicable in respect of such

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failure to deduct and withhold. The employer will not be relieved of his liability for payment of the tax required to be withheld unless he can show that the tax against which the tax under Subd. 6 (7) (b) may be credited has been paid.

2092 (8) LIABILITY FOR TAX

Every employer required to deduct and withhold the tax under M.S.A. 290.92 from the wages of an employee is liable for the payment of such tax whether or not it is collected from the employee by the employer. If, for example, the employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of the tax. See, however, 2092 (6). The employer is relieved of liability to any other person for the amount of any such tax withheld and paid to or deposited with the commissioner.

2092 (10) REMUNERATION OTHER THAN IN CASH FOR SERVICE PERFORMED BY RETAIL COMMISSION SALESMAN

(A) In general. (1) An employer, in computing the amount to be deducted and withheld as tax in accordance with M.S.A. 290.92, may at his election, disregard any wages paid, after October 1, 1961, in a medium other than cash for services performed by him by an employee if (i) the noncash remuneration is paid for services performed by the employee as a retail commission salesman and (ii) the employer ordinarily pays the employee remuneration solely by way of cash commissions for services performed by him as a retail commission salesman.

(2) M.S.A. 290.92, Subd. 10 and this section are not applicable with respect to noncash wages paid to a retail commission salesman for services performed by him in a capacity other than as such a salesman. Such sections are not applicable with respect to noncash wages paid by an employer to an employee for services performed as a retail commission salesman if the employer ordinarily pays the employee remuneration other than by way of cash commissions for such services. Thus, noncash remuner-

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ation may not be disregarded in computing the amount to be deducted and withheld in a case where the employee, for services performed as a retail commission salesman, is paid both a salary and cash commissions on sales, or is ordinarily paid in something other than cash (stocks, bonds, or other forms of property) notwithstanding that the amount of remuneration paid to the employee is measured by sales.

(B) Retail Commission Salesman. For purposes of M.S.A. 290.92, Subd. 10 and this section, the term "retail commission salesman" includes an employee who is engaged in the solicitation of orders at retail, that is, from the ultimate consumer, for merchandise or other products offered for sale by his employer. The term does not include an employee salesman engaged in the solicitation on behalf of his employer of orders from wholesalers, retailers, or others for merchandise for resale. However, if the salesman solicits orders for more than one principal, he is not excluded from the term solely because he solicits orders from wholesalers or retailers on behalf of one or more principals. In such case the salesman may be a retail commission salesman with respect to services performed for one or more principals and not with respect to services performed for his other principals.

(C) Noncash Remuneration. The term "noncash remuneration" includes remuneration paid in any medium other than cash, such as goods or commodities, stocks, bonds, or other forms of property. The term does not include checks or other monetary media of exchange.

2093 (1) DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS

(a) Requirement. A declaration of estimated income tax by an individual is not required if the estimated tax (as defined in M.S.A. 290.93, Subd. 3) can reasonably be expected to be less than $20.

(b) Any taxpayer whose only source of income is wages upon which a tax has been deducted and withheld under M.S.A. 290.92, Subd. 2 or 3 is not required to file a declaration of estimated tax. However, if a taxpayer's only source of income is wages which are not subject to withholding, under the provisions of M.S.A. 290.92, such a taxpayer must file a declaration of estimated tax.

Example. A taxpayer, a legal resident of the State of Minnesota, and making his home in Stillwater, Minnesota, who is employed in the State of Wisconsin.

(c) A declaration is required from a single individual whose gross income is in excess of $750 and from a married couple

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where their combined gross income is in excess of $1,500 if such gross income includes more than $200 from sources other than wages subject to withholding under M.S.A. 290.92.

(d) A parent in estimating his gross income for the taxable year should not take into account the income of his minor child. Such income is not includible in the gross income of the parent. See M.S.A. 290.076.

2093 (2) JOINT DECLARATION BY HUSBAND AND WIFE

(a) In general. A husband and wife may make a joint declaration of estimated tax even though they are not living together. However, a joint declaration may not be made if they are separated under a decree of divorce or a separate maintenance. A joint declaration may not be made if the taxpayer's spouse is not a Minnesota resident, or if his spouse has a different taxable year. If the combined gross income of the married couple meets the requirements of M.S.A. 290.93, Subd. 1, either a joint declaration must be made or a separate declaration must be made by each. If a joint declaration is made by husband and wife, the liability with respect to the estimated tax shall be joint and several.

(b) Application To Separate Returns. The fact that a joint declaration of estimated tax is made by them will not preclude a husband and his wife from filing separate returns. In case a joint declaration is made but a joint return is not made for the same taxable year, the payments made on account of the estimated tax for such year may be treated as payments on account of the tax liability of either the husband or wife for the taxable year or may be divided between them in such manner as they may agree. In the event the husband and wife fail to agree to a division, such payments shall be allocated between them in accordance with the following rule. The portion of such payments to be allocated to a spouse shall be that portion of the aggregate of all such payments as the amount of tax shown on the separate return of the taxpayer bears to the sum of the taxes shown on the separate returns of the taxpayer and his spouse.

(c) Death Of Spouse. (1) A joint declaration may not be made after the death of either the husband or wife. However, if it is reasonable for a surviving spouse to assume that there will be filed a joint return for himself and the deceased spouse for his taxable year and the last taxable year of the deceased spouse he may, in making a separate declaration for his taxable year which includes the period comprising such last taxable year of his spouse, estimate taxable income on an aggregate basis and compute his estimated tax in the same manner as though a joint declaration had been filed.

(2) If a joint declaration is made by husband and wife and thereafter one spouse dies, no further payments of estimated tax

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on account of such joint declaration are required from the estate of the decedent. The surviving spouse, however, shall be liable for the payment of any subsequent installments of the joint estimated tax unless an amended declaration setting forth the separate tax for the taxable year is made by such spouse. Such separate estimated tax shall be paid at the times and in the amounts determined under the rules and prescribed in M.S.A. 290.93, Subd. 6. For the purpose of such amended declaration by the surviving spouse, and allocating the payments made pursuant to the joint declaration between the surviving spouse and the legal representative of the decedent in the event a joint return is not filed, the payments made pursuant to the joint declaration may be divided between the decedent and the surviving spouse in such proportion as the surviving spouse and the legal representative of the decedent may agree. In the event the surviving spouse and the legal representative of the decedent fail to agree to a division, such payments shall be allocated in accordance with the following rule. The portion of such payments to be allocated to the surviving spouse shall be that portion of the aggregate amount of such payments as the amount of tax shown on the separate return of the surviving spouse bears to the sum of the taxes shown on the separate returns of the surviving spouse and of the decedent, and the balance of such payments shall be allocated to the decedent.

(d) Signing Of Declaration. A joint declaration of a husband and wife shall be signed by both spouses or, if signed by one spouse as agent for the other, authorization must accompany the declaration. Both spouses, whether or not one acts as agent for the other, are responsible for making the declaration and incur liability for the penalties provided for erroneous, false, or fraudulent declarations.

2093 (4) CONTENTS OF DECLARATION OF ESTIMATED TAX

In general. The declaration of estimated tax by an individual shall be made on Form MW-1040ES. For the purpose of making the declaration, the amount of gross income which the taxpayer can reasonably be expected to receive or accrue, depending upon the method of accounting upon which taxable income is computed, and the amount of the estimated allowable deductions and credits to be taken into account in computing the amount of estimated tax shall be determined upon the basis of the facts and circumstances existing as at the time prescribed for the filing of the declaration as well as those reasonably to be anticipated for the taxable year. If, therefore, the taxpayer is employed at the date prescribed for filing his declaration at a given wage or salary, it should, in the absence of circumstances indicating the contrary, be presumed by him for the purpose of the declaration that such employment will continue to the end of the taxable

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year at the wage or salary received by him as of such date. In the case of income other than wages and salary the regularity in the payment of income, such as dividends, interest, rents, royalties, and income arising from estates and trusts is a factor to be taken into consideration. Thus, if the taxpayer owns shares of stock in a corporation and dividends have been paid regularly for several years upon such stock, the taxpayer in the preparation of his declaration should, in the absence of information indicating a change in the dividend policy, include the prospective dividends from the corporation for the taxable year as well as those actually received in such year prior to the filing of the declaration. In the case of a taxpayer engaged in business on his own account, there shall be made an estimate of gross income and deductions and credits in the light of the best available information affecting the trade, business, or profession.

2093 (5) TIME AND PLACE FOR FILING DECLARATIONS OF ESTIMATED INCOME TAX BY INDIVIDUALS

(a) Individuals Other Than Farmers. Declarations of estimated tax for the calendar year shall be made on or before April 15th of such calendar year by every individual whose anticipated income for the year meets the requirements of M.S.A. 290.93, Subd. 1. If, however, the requirements necessitating the filing of the declaration are first met, in the case of an individual on the calendar year basis, after April 1st, but before June 2nd of the calendar year, the declaration must be filed on or before June 15th; if such requirements are first met after June 1st and before September 2nd, the declaration must be filed on or before September 15th; and if such requirements are first met after September 1st, the declaration must be filed on or before January 15th of the succeeding calendar year. In the case of an individual on the fiscal year basis, see 2093 (7).

(b) Farmers. In the case of an individual on a calendar year basis, whose estimated gross income from farming for the calendar year is at least two-thirds of his total estimated gross income from all sources for such year, his declaration may be filed on or before the 15th day of January of the succeeding calendar year in lieu of the time prescribed in paragraph (a). For the filing of a return in lieu of a declaration, see 2093 (5). If an individual receives for the use of his land income in the form of a share of the crops produced thereon such income is from farming.

(c) Place For Filing Declaration. The declaration of estimated tax shall be filed with the Commissioner of Taxation, St. Paul, Minnesota.

(d) Amendment Of Declaration. An amended declaration of estimated tax may be filed during any interval between installment dates prescribed for the taxable year. However, no

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amended declaration may be filed until after the installment date on or before which the original declaration was filed and only one amended declaration may be filed during each interval between installment dates. An amended declaration shall be filed with the Commissioner of Taxation, St. Paul, Minnesota.

In the making of a declaration of estimated tax, the taxpayer is required to take into account the then existing facts and circumstances as well as those reasonably to be anticipated relating to prospective gross income, allowable deductions, and estimated credits for the taxable year. Amended or revised declarations may be made in any case in which the taxpayer estimates that his gross income, deductions, or credits will differ from the gross income, deductions, or credits reflected in the previous declaration. An amended declaration may also be made based upon a change in the number of exemptions to which the taxpayer may be entitled for the then current taxable year.

(e) Return As Declaration Or Amendment. (1) If the taxpayer files his return for the calendar year on or before January 31, (or February 15, in the case of an individual referred to in M.S.A. 290.93, Subd. 5 (2), relating to income from farming) of the succeeding calendar year (or if the taxpayer is on a fiscal year basis, on or before the last day of the first month (in the case of a farmer, the 15th day of the second month) immediately succeeding the close of such fiscal year), and pays in full the amount computed on the return as payable, then—

(i) If the declaration is not required to be filed during the taxable year, but is required to be filed on or before January 15 of the succeeding year (or the date corresponding thereto in the case of a fiscal year), such return shall be considered as such declaration; or

(ii) If a declaration was filed during the taxable year, such return shall be considered as the amendment of the declaration permitted by M.S.A. 290.93, Subd. 5 (3) to be filed on or before January 15 of the succeeding year (or the date corresponding thereto in the case of a fiscal year).

Hence, for example, an individual taxpayer on the calendar year basis who, subsequent to September 1, 1962, first meets the requirements of M.S.A. 290.93, Subd. 1 which necessitate the filing of a declaration for 1962, may satisfy the requirements as to the filing of such declaration by filing his return for 1962 on or before January 31, 1963 (February 15, 1963, in the case of a farmer), and paying in full at the time of such filing the tax shown thereon to be payable. Likewise, if a taxpayer files on or before September 15, 1962, a timely declaration for such year and subsequent thereto and on or before January 31, 1963, files his return for 1962, and pays at the time of such filing the tax shown by the return to be payable, such return shall be treated as an amended declaration timely filed.

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(2) For the purpose of M.S.A. 290.93, Subd. 5 (4) a taxpayer may file his return on or before the last day of the first month following the close of the taxable year even though he has not been furnished Form MW-2 by his employer. In such case the taxpayer shall compute, as accurately as possible, his wages for such year and the tax withheld for which he is entitled to a credit, reporting such wages and tax on his return, together with all other pertinent information necessary to the determination of his tax liability for such year.

(3) Compliance with the provisions of M.S.A. 290.93, Subd. 5 (4) will enable a taxpayer to avoid the addition to the tax imposed by M.S.A. 290.93, Subd. 10 with respect to an underpayment of the installment not required to be paid until January 15 of the succeeding calendar year (or the corresponding date in the case of a fiscal year). With respect to an underpayment of any earlier installment, compliance with M.S.A. 290.93, Subd. 5 (4) will not relieve the taxpayer from the addition to the tax imposed by M.S.A. 290.93, Subd. 10. However, the period of the underpayment under M.S.A. 290.93, Subd. 10 (3), with respect to any earlier installment, will terminate on January 15 of the succeeding calendar year (or the corresponding date in the case of a fiscal year). For example, a taxpayer discovers on January 14, 1963, that he has underpaid his estimated tax for the calendar year 1962. He may, in lieu of filing an amended declaration on January 15, 1963, and paying the balance of the estimated tax determined thereon, file his final return on January 31, 1963, and pay in full the amount computed thereon as payable. By so doing, he will avoid the addition to the tax with respect to the underpayment of the installment required to be paid by January 15, 1963. The periods of underpayment, under M.S.A. 290.93, Subd. 10 (3), as to the installments required to be paid on April 15, 1962, June 15, 1962, and September 15, 1962, also terminate on January 15, 1963.

(f) Extensions of Time for Filing Declarations By Individuals. (1) In general. An application for an extension of time for filing a declaration shall be addressed to the Commissioner of Taxation, St. Paul, Minnesota and must contain a full recital of the causes for the delay. Except in the case of taxpayers who are abroad, no extension for filing declarations may be granted for more than six months.

(g) A declaration of estimated tax for the first taxable year beginning after December 31, 1960 shall be filed on December 15, 1961 if the requirements of M.S.A. 290.93, Subd. 1 are first met prior to December 1, 1961. Such declaration shall be prepared in accordance with the provisions of M.S.A. 290.93 and regulations adopted pursuant thereto. However, only twenty-five percent of the estimated tax shall be filed with said declaration.

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(2) Citizens Outside Of The United States. In the case of a taxpayer who is outside the continental United States on the 15th day of the 4th month of his taxable year, an extension of time for filing his declaration of estimated tax otherwise due on or before the 15th day of the 4th month of the taxable year is granted to and including the 15th day of the 6th month of the taxable year.

(3) Addition To Tax Applicable. An extension of time for filing the declaration of estimated tax automatically extends the time for paying the estimated tax (without interest) for the same period. However, such extension does not relieve the taxpayer from the addition to the tax imposed by M.S.A. 290.93, Subd. 10 and the period of the underpayment will be determined under M.S.A. 290.93, Subd. 10 (3) without regard to such extension.

2093 (7)-1 FISCAL YEAR OR SHORT TAXABLE YEAR

(a) Fiscal Year (1) Individuals Other Than Farmers. In the case of an individual on the fiscal year basis, the declaration must be filed on or before the 15th day of the 4th month of the taxable year. If, however, the requirements of M.S.A. 290.93, Subd. 1 are first met after the 1st day of the 4th month and before the 2nd day of the 6th month, the declaration must be filed on or before the 15th day of the 6th month of the taxable year. If such requirements are first met after the 1st day of the 6th month, and before the 2nd day of the 9th month, the declaration must be filed on or before the 15th day of the 9th month of the taxable year. If such requirements are first met after the 1st day of the 9th month, the declaration must be filed on or before the 15th day of the 1st month of the succeeding fiscal year. Thus, if an individual taxpayer has a fiscal year ending on June 30, 1963, his declaration must be filed on or before October 15, 1962, if the requirements of M.S.A. 290.93, Subd. 1 are met on or before October 1, 1962. If, however, such requirements are not met until after October 1, 1962, and before December 2, 1962, the declaration need not be filed until December 15, 1962.

(2) Farmers. An individual on the fiscal year basis whose estimated gross income from farming is at least two-thirds of his total estimated gross income from all sources for such taxable year may file his declaration on or before the 15th day of the month immediately following the close of his taxable year.

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(b) Short Taxable Years of Individuals. (1) Requirement of Declaration. No declaration may be made for a period of more than 12 months. For purposes of M.S.A. 290.93, Subd. 7 a taxable year of 52 or 53 weeks, in the case of a taxpayer who cumputes his taxable income in accordance with the election permitted by M.S.A. 290.40 (2) shall be deemed a period of 12 months. For the purpose of determining the effective date for the applicability of any provision of M.S.A. 290.93 which is expressed in terms of taxable years beginning or ending with reference to the first or last day of a specified calendar month, including the time for filing returns and other documents, paying tax, or performing other acts, a 52-53 week taxable year is deemed to begin on the first day of the calendar month beginning nearest to the first day of the 52-53 week taxable year, and is deemed to end or close on the last day of the calendar month ending nearest to the last day of the 52-53 week taxable year, as the case may be. A separate declaration for a fractional part of a year is required where, for example, there is a change, with the approval of the Commissioner, in the basis of computing taxable income from one taxable year to another taxable year. The periods to be covered by such separate declarations in the several cases are those set forth in M.S.A. 290.40. No declaration is required if the short taxable year is—

(i) A period of less than four months,

(ii) A period of at least four months but less than six months and the requirements of M.S.A. 290.93, Subd. 1 are first met after the 1st day of the fourth month,

(iii) A period of at least six months but less than nine months and the requirements of M.S.A. 290.93, Subd. 1 are first met after the 1st day of the sixth month, or

(iv) A period of nine months or more and the requirements of M.S.A. 290.93, Subd. 1 are first met after the 1st day of the ninth month.

In the case of a decedent, no declaration need be filed subsequent to the date of death. As to the requirement for amended declaration, if death of one spouse occurs after filing a joint declaration, see 2093 (2) (c).

(2) Income Placed On Annual Basis. For the purpose of determining whether the anticipated income for a short taxable year, resulting from a change of annual accounting period, necessitates the filing of a declaration, such income shall be placed on an annual basis in the manner prescribed in M.S.A. 290.32. Thus, for example, a taxpayer who changes from a calendar year basis to a fiscal year basis beginning July 1, 1962, will have a short taxable year beginning January 1, 1962, and ending June 30, 1962. If his anticipated gross income for such short taxable year consists solely of wages in the amount of $500, his total

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gross income and his gross income from such wages for the purpose of determining whether a declaration is required is $1000, the amount obtained by placing anticipated income of $500 upon an annual basis. Hence, assuming such taxpayer is single, he is required to file a declaration of estimated tax for the short taxable year since his anticipated gross income from wages when placed upon an annual basis is in excess of $750.

(3) Individuals Other Than Farmers. In the case of short taxable years the declaration shall be filed on or before the 15th day of the 4th month of such taxable year if the requirements of M.S.A. 290.93, Subd. 1 are met on or before the 1st day of the 4th month of such year. If such requirements are first met after the 1st day of the 4th month but before the 2nd day of the 6th month, the declaration must be filed on or before the 15th day of the 6th month. If such requirements are first met after the 1st day of the 6th month but before the 2nd day of the 9th month, the declaration must be filed on or before the 15th day of the 9th month. If, however, the period for which the declaration is filed is one of 4 months, or one of 6 months and the requirements of M.S.A. 290.93, Subd. 1 are not met until after the 1st day of the 4th month, or one of 9 months and such requirements are not met until after the 1st day of the 6th month, the declaration may be filed on or before the 15th day of the succeeding taxable year.

(4) Farmers. In the case of an individual whose estimated gross income from farming for a short taxable year is at least two-thirds of his total estimated gross income from all sources for such taxable year, his declaration may be filed on or before the 15th day of the month immediately following the close of such taxable year.

2093 (10)-1 UNDERPAYMENT OF ESTIMATED TAX

(a) In general. (1) M.S.A. 290.93, Subd. 10 imposes an addition to the taxes under M.S.A. 290.06 in the case of any underpayment of estimated tax by an individual (with certain exceptions described in M.S.A. 290.93, Subd. 10 (4)). This addition to the taxes is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment. The amount of the underpayment for any installment date is the excess of—

(i) 70 percent (66⅔ percent in the case of individuals referred to in M.S.A. 290.93, Subd. 5 (2), relating to income from farming) of the tax shown on the return for the taxable year or, if no return was filed, 70 percent (66⅔ percent in the case of individuals referred to in M.S.A. 290.93, Subd. 5 (2), relating to income from farming) of the tax for such year, divided by the number of installment dates prescribed for such taxable year, over

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(ii) The amount, if any, of the installment paid on or before the last day prescribed for such payment.

(2) The amount of the addition is determined at the rate of 6 percent per annum upon the underpayment of any installment of estimated tax for the period from the date such installment is required to be paid until the 15th day of the fourth month following the close of the taxable year, or the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment (i) the date prescribed for the payment of any installment of estimated tax shall be determined without regard to any extension of time, and (ii) a payment of estimated tax on any installment date, to the extent that it exceeds the amount of the installment determined under subparagraph (1) (i) of this paragraph for such installment date, shall be considered a payment of any previous underpayment.

(3) In determining the amount of the installment paid on or before the last day prescribed for payment thereof, the estimated tax shall be computed without any reduction for the amount which the taxpayer estimates as his credit under M.S.A. 290.92, Subd. 12 (relating to tax withheld at source on wages), and the amount of such credit shall be deemed a payment of estimated tax. An equal part of the amount of such credit shall be deemed paid on each installment date (determined under M.S.A. 290.93, Subd. 6) for the taxable year unless the taxpayer establishes the dates on which all amounts were actually withheld. In the latter case, all amounts withheld shall be considered as payments of estimated tax on the dates such amounts were actually withheld. Under M.S.A. 290.92, Subd. 12 the entire amount withheld during a calendar year is allowed as a credit against the tax for the taxable year which begins in such calendar year. However, where more than one taxable year begins in any calendar year no portion of the amount withheld during the calendar year will be treated as a payment of estimated tax for any taxable year other than the last taxable year beginning in such calendar year. The rules prescribed in this subparagraph for determining the time as of which the amount withheld shall be deemed paid are applicable even though such amount was withheld during a taxable year preceding that for which the credit is allowed.

(4) The term "tax" when used in subparagraph (1) (i) of this paragraph shall mean the tax imposed by chapter 290 reduced by all credits allowed by that chapter except the credit provided by M.S.A. 290.92, Subd. 12, relating to tax withheld at source on wages.

(b) Statement Relating To Underpayment. If there has been an underpayment of estimated tax as of any installment date prescribed for its payment and the taxpayer believes that one or

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more of the exceptions described in 2093 (10)-2 precludes the assertion of the addition to the tax under M.S.A. 290.93, Subd. 10, he should attach to his income tax return for the taxable year, a schedule showing the applicability of any exception upon which he relies.

2093 (10)-2 EXCEPTIONS TO IMPOSITION OF THE ADDITION TO THE TAX IN THE CASE OF INDIVIDUALS

(a) In general. The addition to the tax under M.S.A. 290.93, Subd. 10 will not be imposed for any underpayment of any installment of estimated tax if, on or before the date prescribed for payment of the installment, the total amount of all payments of estimated tax made equals or exceeds the least of the following amounts—

(1) The amount which would have been required to be paid on or before the date prescribed for payment if the estimated tax were the tax shown on the return for the preceding taxable year, provided that the preceding taxable year was a year of 12 months and a return showing a liability for tax was filed for such year;

(2) The amount which would have been required to be paid on or before the date prescribed for payment if the estimated tax were an amount equal to a tax determined on the basis of the tax rates and the taxpayer's status with respect to personal credits under M.S.A. 290.06, Subd. 3 for the taxable year, but otherwise on the basis of the facts shown on the return for the preceding taxable year and the law applicable to such year, in the case of an individual required to file a return for such preceding taxable year;

(3) The amount which would have been required to be paid on or before the date prescribed for payment if the estimated tax were an amount equal to 70 percent (66⅔ percent in the case of individuals referred to in M.S.A. 290.93, Subd. 5 (2), relating to income from farming) of the tax computed by placing on an annual basis the taxable income for the calendar months in the taxable year preceding such date. The taxable income shall be placed on an annual basis by—

(i) Multiplying by 12 (or the number of months in the taxable year if less than 12) the taxable income (computed without the standard deduction and without the deductions for personal exemptions), or the adjusted gross income if the standard deduction is to be used, for such calendar months,

(ii) Dividing the resulting amount by the number of such calendar months, and

(iii) Deducting from such amount the standard deduction, if applicable, and the deductions for personal exemptions (such

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personal exemptions being determined as of the date prescribed for payment); or

(4) An amount equal to 90 percent of the tax computed, at the rates applicable to the taxable year, on the basis of the actual taxable income for the calendar months in the taxable year preceding the date prescribed for payment.

In the case of a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with M.S.A. 290.40 (2), the rules prescribed by 2093 (7)-1 (2) shall be applicable in determining for purposes of subparagraph (1) of this paragraph, whether a taxable year was a year of 12 months and, for purposes of subparagraphs (3) and (4) of this paragraph, the number of calendar months in a taxable year preceding the date prescribed for payment of an installment of estimated tax.

(b) Meaning Of Terms. As used in this section and 2093 (10)-3.

(1) The term "tax" means the tax imposed by chapter 290 reduced by the credits against tax allowed by such chapter, other than the credit against tax provided by M.S.A. 290.92, Subd. 12 (relating to tax withheld on wages), and without reduction for any payments of estimated tax.

(2) The term "return for the preceding taxable year" means the income tax return for such year which is required by M.S.A. 290.37.

(c) Determination Of Taxable Income For Installment Periods. (1) In general. (i) In determining the applicability of the exceptions described in paragraph (a) (3) and (4) of this section, there must be an accurate determination of the amount of income and deductions for the calendar months in the taxable year preceding the installment date as of which the determination is made, that is, for the period terminating with the last day of the third, fifth, or eighth month of the taxable year. For example, a taxpayer distributes year-end bonuses to his employees but does not determine the amount of the bonuses until the last month of the taxable year. He may not deduct any portion of such year-end bonuses in determining his taxable income for any installment period other than the final installment period for the taxable year, since deductions are not allowable until paid or accrued, depending on the taxpayer's method of accounting.

(ii) If a taxpayer on an accrual method of accounting wishes to use either of the exceptions described in paragraph (a) (3) and (4) of this section, he must establish the amount of income and deductions for each applicable period. If his income is derived from a business in which the production, purchase, or sale of merchandise is an income-producing factor requiring the use

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of inventories, he will be unable to determine accurately the amount of his taxable income for the applicable period unless he can establish, with reasonable accuracy, his cost of goods sold for the applicable installment period. The cost of goods sold for such period shall be considered, unless a more exact determination is available, as such part of the cost of goods sold during the entire taxable year as the gross receipts from sales for such installment period is of gross receipts from sales for the entire taxable year.

(2) Members Of Partnerships. The provisions of this subparagraph shall apply in determining the applicability of the exceptions described in paragraph (a) (3) and (4) of this section to an underpayment of estimated tax by a taxpayer who is a member of a partnership.

(i) There shall be taken into account—

(a) The partner's distributive share of partnership items set forth under M.S.A. 290.31, Subd. 2.

(b) The amount of any guaranteed payments under M.S.A. 290.31, Subd. 7 (4), and

(c) Gains or losses on partnership distributions which are treated as gains or losses on sales of property.

In determining a partner's taxable income for the months in his taxable year which precede the month in which the installment date falls, the partner shall take into account items set forth in M.S.A. 290.31, Subd. 2 for any partnership taxable year ending with or within his taxable year to the extent that such items are attributable to months in such partnership taxable year which precede the month in which the installment date falls. In addition, a partner shall include in his taxable income for the months in his taxable year which precede the month in which the installment date falls guaranteed payments from the partnership to the extent that such guaranteed payments are includible in his taxable income for such months. See M.S.A. 290.31, Subd. 6 (1) and Subd. 7 (4).

(3) Beneficiaries Of Estates And Trusts. In determining the applicability of the exceptions described in paragraph (a) (3) and (4) of this section as of any installment date, the beneficiary of an estate or trust must take into account his distributable share of income from the estate or trust for the applicable period (whether or not actually distributed) if the trust or estate is required to distribute income to him currently. If the estate or trust is not required to distribute income currently, only the amounts actually distributed to the beneficiary during such period must be taken into account. If the taxable year of the beneficiary and the taxable year of the estate or trust are different, there shall be taken into account the beneficiary's distributable

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share of income, or the amount actually distributed to him as the case may be, during the months in the taxable year of the estate or trust ending within the taxable year of the beneficiary which precede the month in which the installment date falls.

(d) Special Rule In Case Of Change From Joint Return Or Separate Return For The Preceding Taxable Year. (1) Joint Return To Separate Return. In determining the applicability of the exceptions described in paragraph (a) (1) and (2) of this section to an underpayment of estimated tax, a taxpayer filing a separate return, who participated in the filing of a joint return for the preceding taxable year, shall be subject to the following rule. The tax—

(i) Shown on the return for the preceding taxable year, or

(ii) Based on the tax rates and personal credits for the taxable year but otherwise determined on the basis of the facts shown on the return for the preceding taxable year, and the law applicable to such year,

shall be that portion of the tax which bears the same ratio to the whole of the tax as the amount of tax for which the taxpayer would have been liable bears to the sum of the taxes for which the taxpayer and his spouse would have been liable had each spouse filed a separate return for the preceding taxable year.

(2) Separate Return To Joint Return. In the case of a taxpayer who participates in the filing of a joint return for the taxable year with respect to which there is an underpayment of estimated tax and who filed a separate return for the preceding taxable year—

(i) The tax shown on the return for the preceding taxable year, for purposes of determining the applicability of the exception described in paragraph (a) (1) of this section, shall be the sum of both the tax shown on the return of the taxpayer and tax shown on the return of the taxpayer's spouse for such preceding year, and

(ii) The facts shown on both the taxpayer's return and the return of his spouse for the preceding taxable year shall be taken into account for purposes of determining the applicability of the exception described in paragraph (a) (2) of this section.

2093 (10)-3 SHORT TAXABLE YEARS OF INDIVIDUALS

(a) In general. The provisions of M.S.A. 290.93, Subd. 10, with certain modifications which are explained in paragraph (b) of this section, are applicable in the case of a short taxable year for which a declaration is required to be filed. (See 2093 (7)-1 for requirement of declaration for short taxable year.)

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(b) Rules As To Application Of M.S.A. 290.93, Subd. 10 (4). (1) In any case in which the taxable year for which an underpayment of estimated tax exists is a short taxable year due to a change in annual accounting periods, in determining the tax—

(i) Shown on the return for the preceding taxable year (for purposes of M.S.A. 290.93, Subd. 10 (4)), or

(ii) Based on the personal exemptions and rates for the current taxable year but otherwise on the basis of the facts shown on the return for the preceding taxable year, and the law applicable to such year (for purposes of M.S.A. 290.92, Subd. 10 (4)),

the tax will be reduced by multiplying it by the number of months in the short taxable year and dividing the resulting amount by 12.

(2) If the taxable year for which an underpayment of estimated tax exists is a short taxable year due to a change in annual accounting periods, in annualizing the income for the months in the taxable year preceding an installment date, for purposes of M.S.A. 290.93, Subd. 10 (4), the personal exemptions allowed as deductions under M.S.A. 290.06, Subd. 3 (1) (2) (3) shall be reduced to the same extent that they are reduced under M.S.A. 290.06, Subd. 3 (6) in computing the tax for a short taxable year.

(3) If "the preceding taxable year" referred to in M.S.A. 290.93, Subd. 10 (4) (b) was a short taxable year, the tax computed on the basis of the facts shown on the return for such preceding year, for purposes of determining the applicability of the exception described in M.S.A. 290.93, Subd. 10 (4), shall be the tax computed on the annual basis in the manner described in M.S.A. 290.32. If the tax rates or the taxpayer's status with respect to personal exemptions for the taxable year with respect to which the underpayment occurs differ from such rates or status applicable to the preceding taxable year, the tax determined in accordance with the preceding sentence shall be recomputed to reflect the rates and status applicable to the year with respect to which the underpayment occurs.

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2093.1-3 CONTENTS OF DECLARATION OF ESTIMATED TAX.

(a) In General. The declaration of estimated tax by a corporation shall be made on Form M-18, and by a bank on Form M-20. For the purpose of making the declaration, the estimated tax should be based upon the amount of gross income which the taxpayer can reasonably be expected to receive or accrue as the case may be, depending upon the method of accounting upon the basis of which the taxable income is computed, and the amount of the estimated allowable deductions and credits to be taken into account. Such amounts of gross income, deductions, and credits should be determined upon the basis of facts and circumstances existing as at the time prescribed for the filing of the declaration as well as those reasonably to be anticipated for the taxable year.

(b) Use of Prescribed Form. Copies of Form M-18 and M-20 will so far as possible be furnished taxpayers. A taxpayer will not be excused from making a declaration, however, by the fact that no form has been furnished. Taxpayers not supplied with the proper form should make application therefor to the Department of Taxation in ample time to have their declarations prepared, verified, and filed with the department on or before the date prescribed for filing the declaration. If the prescribed form is not available a statement disclosing the estimated income tax after the exemption and the credits, if any, should be filed as a tentative declaration within the prescribed time, accompanied by the payment of the required installment. Such tentative declaration should be supplemented, without unnecessary delay, by a declaration made on the proper form and notice given at that time that a tentative declaration has been filed.

2093.1-5 SHORT TAXABLE YEAR.

(a) Requirement of Declaration. No declaration may be made for a period of more than 12 months. For purposes of this section a taxable year of 52 or 53 weeks, in the case of a corporation which computes its taxable income in accordance with the election permitted by section 290.40, shall be deemed a period of 12 months. A separate declaration is required where a corporation is required to submit an income tax return for a period of less than 12 months, but only if such short period begins after December 31, 1964.

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(b) Election of Year Consisting of 52-53 Weeks. Section 290.40 provides in general, that a taxpayer may elect to compute his taxable income on the basis of a fiscal year which varies from 52 to 53 weeks, ends always on the same day of the week, and ends always on whatever date this same day of the week last occurs in a calendar month, or whatever date this same day of the week falls which is nearest to the last day of the calendar month.

For the purpose of determining the effective date for the applicability of any provision of chapter 290 which is expressed in terms of taxable years beginning or ending with reference to the first or last day of a specified calendar month, including the time for filing returns and other documents, paying tax, or performing other acts, a 52-53-week taxable year is deemed to begin on the first day of the calendar month beginning nearest to the first day of the 52-53-week taxable year, and is deemed to end or close on the last day of the calendar month ending nearest to the last day of the 52-53-week taxable year, as the case may be.

2093.2-4 EXTENSION OF TIME FOR FILING DECLARATIONS BY CORPORATIONS.

(a) In General. The commissioner is authorized to grant a reasonable extension of time for filing a declaration or an amended declaration. An application by a corporation for an extension of time for filing such a declaration shall be addressed to the commissioner and must contain a full recital of the causes for the dalay.

(b) Addition to Tax Applicable. An extension of time granted to a corporation for filing a declaration of estimated tax automatically extends the time for paying the estimated tax (without interest) for the same period. However, such extension does not relieve the corporation from the addition to the tax imposed by section 290.934 and the period of the underpayment will be determined under section 290.934, subdivision 3 without regard to such extension.

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2093.3-1 INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.

(a) Amount and Time for Payment of Each Installment. Paragraphs (1) through (4) of Section 290.933, Subdivision 1, contain four tables setting forth the percentages of estimated tax which shall be paid as installments of estimated tax and the date on or before which such installments shall be paid. The date on or before which the declaration of estimated tax for a taxable year is required under the provisions of Section 290.932, Subdivision 1, to be filed, determines which of the four installment payment tables shall be used by the corporation for that taxable year. Therefore, if the declaration is required to be filed by the 15th day of the 3rd, 6th, 9th or 12th month, the estimated tax will be required to be paid in four, three, two or one installment respectively.

(b) Late Filing of Declaration of Estimated Tax. If a declaration of estimated tax is filed after the date prescribed by Section 290.932, Subdivision 1 (determined without regard to any extension of time for filing the declaration under Section 290.932, Subdivision 4), the tables set forth in paragraphs (2), (3), and (4) of Section 290.933, Subdivision 1, do not apply except as provided in this regulation. In such a case, there shall be paid at the time of the filing of the declaration all installments of the estimated tax which would have been payable under the appropriate table in Section 290.933, Subdivision 1, on or before such date of filing if the declaration had been timely filed in accordance with the provisions of Section 290.932, Subdivision 1. The remaining installments shall be paid at the times and in the amounts in which they would have been payable if the declaration had been timely filed.

2093.3-2 AMENDMENT OF DECLARATION.

If any amendment of a declaration is filed, the amount of each remaining installment (including the installment due on the date of the filing of the amendment where the amendment is filed on an installment date), if any, is the amount which would have been payable as such installment if the new estimate had been the original estimate adjusted as provided in this regulation. The adjustment is for the difference between (a) the amount of estimated tax required to be paid before the date of the filing of the amendment and (b) the amount of estimated tax which would have been required to have been paid before such date if the new estimate had been the original estimate. The difference is divided by the number of remaining installments (including the installment due on the date of the filing of the amendment where the amendment is filed on an installment date), and the resulting amount is added to (if the amended declaration increases the amount of estimated tax) or subtracted from (if the amended declaration decreases the amount of the estimated tax) the amount which would have been payable on each remaining installment date if the new estimate had been the original estimate.

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FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX

2093.4-1 ADDITION TO THE TAX.

Section 290.934, Subdivision 1, imposes an addition to the tax under Chapter 290 in the case of any underpayment of estimated tax made by a corporation (with certain exceptions described in Section 290.934, Subdivision 4). This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

2093.4-3 PERIOD OF UNDERPAYMENT.

The amount of the addition is determined at the rate of six percent per annum upon the underpayment of any installment of estimated tax for the period from the date such installment is required to be paid until the 15th day of the third month following the close of the taxable year, or the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment (i) the date prescribed for payment of any installment of estimated tax shall be determined without regard to any extension of time, and (ii) a payment of estimated tax on any installment date, to the extent that it exceeds the amount of the installment determined under paragraph (1) hereof for such date, shall be considered a payment of the previous underpayment, if any.

If there has been an underpayment of estimated tax as of the installment date prescribed for its payment and the taxpaper believes that one or more of the exceptions described in Section 290.934, Subdivision 4, precludes the assertion of the addition to the tax it should attach to its income tax return for the taxable year a form 429-C showing the applicability of any exception upon which the taxpayer relies.

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2093.5 APPLICATION OF PAYMENT OF ESTIMATED TAX.

Payments of estimated tax shall be considered payments on account of the income tax liability for the taxable year. Hence, the amount of estimated tax paid shall be entered on the income tax return and applied in payment of the tax liability shown thereon (a corporation may at its election pay any installment of its estimated tax in advance of the due date).

The commissioner, within the applicable period of limitations, may credit any overpayment of tax including interest thereon against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the taxpayer making the overpayment and the balance, if any, shall be refunded to such taxpayer by the commissioner. (See M.S.A. 290.50 and Reg. 2050(5))

An income tax return shall, at the election of the taxpayer, constitute a claim for refund or credit of an overpayment disclosed by such return. Such claim shall be considered as filed on the date on which the return is considered as filed. An election to treat the return as a claim for refund or credit shall be evidenced by a statement on the return setting forth the amount determined as an overpayment and advising whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated income tax for the taxable year immediately succeeding the taxable year for which such return is filed. If the taxpayer elects to have all or part of the overpayment shown by his return applied to his estimated income tax for his succeeding taxable year, no interest shall be allowed on such portion of the overpayment credited and such amount shall be applied as a payment on account of the estimated income tax for such year or the installments thereof. In any case in which a taxpayer elects to have an overpayment refunded to him he may not thereafter change his election to have the overpayment applied as a payment on account of his estimated income tax.

If any installment of tax is overpaid, the overpayment shall first be applied against any outstanding installments of such tax. If the overpayment exceeds the correct amount of tax due, the overpayment shall be credited or refunded as provided in this regulation.

2097 CONTRACTS WITH STATE; WITHHOLDING; CERTIFICATION

M.S.A. 290.97 provides that no department of the State of Minnesota nor any political or governmental subdivision thereof shall make final settlement with any contractor, under a contract requiring the employment of employees for wages by said contractor, until satisfactory showing is furnished to said department or governmental subdivision that the contractor in ques-

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tion has complied with the withholding provisions of M.S.A. 290.92. The statute further provides that a certificate issued by the Commissioner of Taxation shall satisfy this requirement.

The provisions of the statute are prospective in their effect and apply only to contracts executed after April 7, 1961. To facilitate the obtaining of the certification provided for by M.S.A. 290.97 the Commissioner has made available Form 134. This form is in two parts, the first section thereof is in the form of an affidavit to be executed by a prime contractor or subcontractor and the second portion thereof is the Commissioner's certification. The affidavit portion of the form in any event requires that certain identifying information be set forth by the affiant such as the name of the contractor, his address, withholding identification number, the number of the contract or contracts involved and the name of the department of the State or governmental subdivision with whom he has contracted. The affidavit itself is divided into two parts "A" and "B" and it is intended that part "A" will be executed by both a prime contractor or subcontractor with respect to the employees of such prime contractor or subcontractor.

Part "B" of said affidavit is to be executed only by a prime contractor who has utilized subcontractors in completing his contract with the State or governmental subdivision thereof. In such a case it is contemplated that each subcontractor will execute part "A" of the affidavit on Form 134 and obtain from the Commissioner certification with respect to such subcontractors own employees. This copy of Form 134 certified to with respect to the subcontractor's employees will be given to the prime contractor who should keep such affidavit and certification in his own files. When the prime contractor has received such an affidavit and certification from all of his subcontractors on the contract, he will then be in a position to execute part "B" of the affidavit as well as part "A" and obtain a certification from the Commissioner as to his own employees. This Form 134, where both parts "A" and "B" have been executed by the prime contractor and certified to by the Commissioner, should then be delivered to the department or governmental subdivision in satisfaction of the requirements of M.S.A. 290.97.

The withholding section of the Department of Taxation will process these affidavits and any requests for Forms 134 or inquiries relative to their use and application should be directed to this section.

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2097.3 (2) TAXABLE INCOME DEFINED — PARTNERSHIP RETURN REQUIRED

Any corporation which has elected under the provisions of M.S.A. 290.972 to be taxed in accordance with the provisions of said section shall file with the Commissioner of Taxation a return on the form prepared for such purpose and in accordance with instructions issued by the Commissioner. No corporate income tax return need be filed for such electing corporations.

2097.3 (3) AMOUNT INCLUDED IN GROSS INCOME OF SHAREHOLDER

Individual shareholders of an electing corporation under M.S.A. 290.972 shall be required to make an adjustment with respect to their federal adjusted gross income in determining Minnesota tax liability in the following situations:

(1) Where the electing corporation has sustained capital gains during the taxable year and the adjusted basis of such capital assets is different for state and federal purposes, appropriate adjustment shall be made in conformance with the provisions of M.S.A. 290.01, Subdivision 20(b) (2).

(2) Where the business of the corporation is carried on both within and without the state of Minnesota, proper allocation of corporate income or loss attributable to shareholders shall be made under the provisions of M.S.A. 290.17, 18 and 19.

(3) In cases where during the taxable year there has been a distribution of money or property in the form of dividends or otherwise to shareholders (other than in liquidation) in excess of the corporations taxable income for the year then to the extent of the available surplus accumulated prior to years when the corporation was an electing corporation such excess shall be added to the shareholders federal adjusted gross income in determining Minnesota tax liability.

The basis of a shareholders stock in an electing small business corporation shall be reduced (but not below zero) by an amount equal to the amount of his portion of the corporations net operating loss for any taxable year attributable to such stock (as determined under Section 1374(c) of the Internal Revenue Code of 1954, as amended) and which loss was utilized as a deduction in determining the individuals Minnesota income tax liability.

In the event that an electing corporation under M.S. 290.971 through 290.975 pays a Federal income tax liability of said corporation during the taxable year when the corporation was an electing corporation as stated above, the shareholders shall be entitled, on their individual returns, to deduct a proportionate amount of such Federal income tax payment equal to their proportionate interest in the corporation.

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13 MCAR § 1.6001 Resident defined. *(Effective date 6/30/81)*

A. General statements.

1. The term "resident" means any individual person maintaining a home in Minnesota during any part of a tax year who is, during that part of such year, domiciled in Minnesota. The term "domicile" means the bodily presence of an individual person in a place coupled with an intent to make such a place one's home.

2. The domicile of any person shall be that place in which that person's habitation is fixed, without any present intentions of removal therefrom, and to which, whenever absent, that person intends to return.

A person who leaves home to go into another jurisdiction for temporary purposes only is not considered to have lost that person's domicile. But if a person moves to another jurisdiction with the intention of remaining there permanently or for an indefinite time as a home, that person shall have lost that person's domicile in this state. The presumption is that a person who leaves this state to accept a job assignment in a foreign nation has not lost that person's domicile in this state.

The presumption is that the place where a person's family is domiciled is that person's domicile. The domicile of a spouse shall be the same as the other spouse, unless there is affirmative evidence to the contrary or unless the husband and wife are legally separated or the marriage has been dissolved. When a person has made a home at any place with the intention of remaining there and the person's family neither lives there nor intends to do so, then that person shall have established a domicile separate from that person's family.

The domicile of a single person is that person's usual home. In case of a minor child who is not emancipated, the domicile of the child's parents is the domicile of the child. The domicile of the parent who has legal custody of the child is the domicile of the child. A person who is a permanent resident alien in the United States may have a domicile in this state. The domicile of a member of the armed forces will be governed by the facts just prior to becoming a member of the armed forces unless the person takes the necessary steps to establish a new domicile.

3. The mere intention to acquire a new domicile, without the fact of physical removal, does not change the status of the taxpayer, nor does the fact of physical removal, without the intention to remain, change the person's status. The presumption is that one's domicile is the place where one lives. An individual can have only one domicile at any particular time. A domicile once shown to exist is presumed to continue until the contrary is shown. An absence of intention to abandon a domicile is equivalent to an intention to retain the existing one. No positive rule can be adopted with respect to the evidence necessary to prove an intention to change a domicile but such intention may be proved by acts and declarations, and of the two forms of evidence, acts shall be given more weight than declarations. A person

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who is temporarily employed within this state does not acquire a domicile in this state, if during such period the person is domiciled without this state.

B. The following items listed will be considered in determining whether or not a person is domiciled in this state:

1. Location of domicile for prior years.

2. Where the person votes or is registered to vote. Casting an illegal vote does not establish domicile for income tax purposes.

3. Status as a student.

4. Classification of employment as temporary or permanent.

5. Location of employment.

6. Location of newly acquired living quarters whether owned or rented.

7. The present status of the former living quarters, i.e., was it sold, offered for sale, rented or available for rent to another.

8. Homestead status has been requested and/or obtained for property tax purposes on newly purchased living quarters and the homestead status of the former living quarters has not been renewed.

9. Ownership of other real property.

10. Jurisdiction in which a valid driver's license was issued.

11. Jurisdiction from which any professional licenses were issued.

12. Location of the person's union membership.

13. Jurisdiction from which any motor vehicle license was issued and the actual physical location of the vehicles.

14. Purchased resident or nonresident fishing or hunting licenses.

15. Whether an income tax return has been filed as a resident or nonresident.

16. Whether the person has fulfilled the tax obligations required of a resident.

17. Location of any bank accounts, especially the location of the most active checking account.

18. Location of other transactions with financial institutions.

19. Location of the place of worship at which the person is a member.

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20. Location of business relationships and the place where business is transacted.

21. Location of social, fraternal, or athletic organizations or clubs or in a lodge or country club, in which the person is a member.

22. Address where mail is received.

23. Percentage of time (not counting hours of employment) that the person is physically present in Minnesota and the percentage of time (not counting hours of employment) that the person is physically present in each jurisdiction other than Minnesota.

24. Location of jurisdiction from which unemployment compensation benefits are received.

25. Location of schools at which the person, the person's spouse or children attend, and whether resident or nonresident tuition was charged.

26. Statements made to an insurance company, concerning the person's residence, and on which the insurance is based.

Any one of the items listed above will not, by itself, determine domicile.

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13 MCAR § 1.6002 Income tax returns for husband and wife. *(Effective date 6/30/81)*

A. The determination of whether an individual is married shall be made as of the close of the taxable year; except that if a surviving spouse does not remarry during the taxable year such determination shall be made as of the date of death. An individual shall not be considered to be married if the marriage has been dissolved or if they are legally separated or if they do not live together, unless the spouse is only temporarily away from home. No joint or combined return can be made if the husband and wife have different taxable years. In the case where one spouse dies, a joint or combined return may be filed if the surviving spouse has not remarried before the close of their taxable year.

B. A husband and wife may elect to file (1) a single return jointly (joint return), (2) separate returns, or (3) separately on one return ("combined" return).

C. If a husband and wife elect to each file a separate income tax return, or if they elect to file a combined return, each spouse must report that spouse's own federal adjusted gross income. On separate or combined returns, each spouse may claim only those deductions and credits that spouse is separately entitled to claim except that on separate or combined returns the married credit, or on a combined return, itemized deductions, may be claimed in full by one spouse or may be divided between them in any manner. On separate or combined returns, deductions for which each spouse is equally liable and which are paid from a joint account may be considered as being paid by either spouse.

Income and losses from jointly held property must be divided based on percentage of ownership in the property. Income and losses from a partnership which operates a business must be reported on the basis of the partnership agreement. Income and losses from a business that is not governed by a partnership agreement must be reported on the basis of participation in and contributions to the partnership or joint business venture and this is determined according to the (1) percentage of contribution to the capital assets, (2) percentage of labor performed, and (3) percentage of participation in management decisions. Interest income from a joint bank account or jointly held bonds and dividends on jointly held stocks shall be divided equally unless it can be shown that a different allocation is more appropriate. A gain or a loss from the sale or exchange of a capital asset shall be reported by the spouse owning the capital asset. A gain or a loss from the sale or exchange of a capital asset owned jointly by the spouses shall be divided equally unless it can be shown that a different allocation is more appropriate.

D. If both husband and wife are residents of a community property state or nation, it is permissible for them to split their income and losses based on the law of their residence. Otherwise, it is not permissible for a husband and wife to split their income and losses or to assign it to the other spouse unless there is a business relationship or unless it is required under the provisions of the Internal Revenue Code.

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E. The liability of each spouse on a separate return is limited to the tax liability on that return. If a combined return is filed and if later an adjustment is made to an item of income, or modification to income, which is attributable solely to one spouse, only that spouse is liable for any additional tax.

F. Where a husband and wife filed joint or combined returns and subsequently are no longer married within the definition of Part A., an amended return, claim for refund, or net operating loss or farm loss carryback claim filed by one of the former spouses shall be allowed if the item is attributable to that spouse to the extent of that spouse's tax liability. Where a joint return was filed, the spouse's tax liability shall be determined according to the following formula:

$$\frac{\text{Spouse's recomputed separate tax liability}}{\text{Both spouses' recomputed separate tax liability.}} \times \text{Recomputed joint tax liability} = \text{Spouse's share of joint tax liability}$$

The spouse's share of the joint liability is then subtracted from the spouse's contributions through withholding or estimated tax or other payments which were made to pay that joint liability. The amount of the refund to be made to the spouse cannot exceed the amount of the joint overpayment shown on the amended return or claim for refund. Where a combined return was filed, the spouse's tax liability shall be determined as if an amended return was filed.

When an amended joint or combined return is filed, items paid out of joint funds of the husband and wife shall be divided between the spouses to provide the greatest tax benefit to both spouses unless both spouses had previously elected another method. Joint estimated tax declarations shall be divided according to the provisions of Income Tax Rule 2093(2). Where credits are not paid out of joint funds, the credit shall belong to the spouse who made the payment on which the credit is based. The homemaker credit and the married credit may be divided equally between the spouses. The homemaker credit and the dependent care credit are not allowed to be claimed on separate returns filed by a married couple.

When an amended joint or combined return or a claim for refund is filed under this part, no refund will be given to a spouse unless an amended return or claim for refund is filed by that spouse. No additional tax liability may be created and assessed against a spouse unless an amended return is filed by that spouse or there is an audit done by the department.

G. Persons who become married during the taxable year may file a joint, combined, or a separate return if they are married and living together at the close of the taxable year. Married persons who were legally separated or living apart during any part of the taxable year may file a joint, combined, or a separate return if they were living together at the close of the taxable year.

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H. Except as provided by law in the case of a death of a spouse, a joint or a combined return must be signed by both husband and wife unless (a) the return is made by an agent of both the husband and wife, or (b) one spouse signs as the agent of the other. Any spouse who makes a joint or a combined return through an agent assumes the responsibility for making the return and incurs liability for the penalty provided for erroneous, false, or fraudulent returns. One spouse cannot sign as the agent of the other unless the return is accompanied by a power of attorney authorizing such action by the spouse not signing the return. Other agents must also submit their power of attorney with the return.

I. The election of a husband and wife to file joint, combined, or separate returns may be changed by the husband and wife if (1) they both sign and file an amended return reflecting the change of election to file a joint or combined return or (2) each spouse signs and files an amended return reflecting the change of election to file a separate return. The change in the election may be made at any time within the period provided for the assessment of additional taxes.

J. When a husband and wife file a joint federal income tax return and file a separate or combined Minnesota income tax return, they shall determine their Minnesota gross income separately as if their federal adjusted gross income had been determined separately. Any income exclusion or adjustment to income (such as the disability income exclusion), allowed in arriving at federal adjusted gross income which requires them to file a joint federal return will be allowed in determining Minnesota gross income even though they elect to file separate or combined returns for Minnesota. However, if a deduction allowed or a loss limitation provided in computing federal adjusted gross income (such as the capital loss limitation) is reduced by one half if separate federal returns had been filed, the Minnesota gross income of each spouse reflected on a separate or combined Minnesota return will be computed as though separate federal returns had been filed including the reduced deduction or loss limitation. As a result a spouse may have a different capital loss carryover for Minnesota than was allowed on the federal return.

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13 MCAR § 1.6003 Minnesota gross income for individuals who are full-year Minnesota residents (Federal Adjusted Gross Income) *(Effective date 6/30/81)*

A. The beginning point in the determination of Minnesota gross income is federal adjusted gross income. Federal adjusted gross income for Minnesota residents should be the same as the federal adjusted gross income that is used for federal purposes. If no federal tax return was filed for that year, federal adjusted gross income for Minnesota must be calculated using the appropriate Internal Revenue Code as if a federal tax return had been filed. Federal adjusted gross income for Minnesota is defined in Minn. Stat. § 290.01, subd. 20 as being the federal adjusted gross income as defined in the Internal Revenue Code on a certain date. Unless the legislature specifies otherwise, provisions that affect federal adjusted gross income for future years and which have been enacted by Congress as of December 31 of the year set by the legislature, become effective for Minnesota income tax purposes at the same time they become effective for federal income tax purposes. (If the federal change in the Internal Revenue Code is effective for years beginning after December 31, 1980, but is enacted as an amendment in 1979, the change is effective for Minnesota for taxable years beginning after December 31, 1980, also, since present conformity to the Internal Revenue Code includes federal amendments through December 31, 1979.) Provisions that affect federal adjusted gross income and which have been enacted by Congress after December 31 of the year set by the legislature do not become effective until the legislature passes a law to adopt the provisions or to update the reference to December 31, of a certain year.

B. All income and losses, regardless of the source, are assignable to Minnesota. Pay received by a member of the military who is a Minnesota resident and who is outside of the state of Minnesota while receiving the pay is includible for Minnesota purposes, as is income received by any other resident.

Income and gains from the sale or other disposition of property which is reported on the installment method and is included in federal adjusted gross income is included in Minnesota gross income even though the property was located outside of Minnesota and the sale occurred prior to 1978. For purposes of computing the amount of the gain that would be included in Minnesota income, the basis will be determined under the provisions of Part D.2. of this rule.

C. Losses.

1. Losses included in federal adjusted gross income which were incurred in connection with out of state income are allowable in full with the following exception. Out of state losses are reduced by the taxpayer's tax preference items which are attributable to those losses but only to the extent of those losses. The preference items of depletion and capital gains deduction shall not be used to reduce a taxpayer's out of state loss.

The preference item, intangible drilling costs, is defined as being the amount

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of the excess intangible drilling costs arising in the taxable year which exceed the amount of the net income from productive wells of the taxpayer from oil, gas, and geothermal properties for the taxable year.

2. Each loss will be considered separately for the purpose of making this computation. A separate loss would consist of:

a. Each separate operation within an individual proprietorship.

b. Each separate operation within a partnership, limited partnership, joint venture, or small business corporation.

c. Each transaction regarding the sale of a capital asset or an asset utilized in a trade or business provided that the sale of such asset is not part of an ongoing operation.

3. When an out of state loss is reduced by a tax preference item which is reflected in the computation of the adjusted basis of property, the reduction in basis which was made for federal purposes would not be made for Minnesota purposes to the extent of the amount of the loss which was reduced by that specific preference item. The taxpayer may elect to not reduce the basis of a depletable asset or the taxpayer may reduce the amount of otherwise taxable income subsequently produced by that asset in subsequent taxable years by the amount of the reduction that was required to be made to the out of state loss because of these tax preference items.

4. A net operating loss carryback or carryforward which has been used in the calculation of federal adjusted gross income must be reduced by the amount of tax preference items attributable to the out of state loss.

5. A modification increasing federal adjusted gross income in the amount of the losses that are disallowed must be made.

D. As provided in B., all income and losses are assignable to Minnesota. The following are types of income or losses from sources outside of Minnesota:

1. Farm income or loss from a farm located outside of Minnesota.

2. Income, gains, or losses from tangible property, such as real estate, which is located outside of Minnesota. Oil, gas, coal and mineral leases are interests in real property. The following would also be out of state income or losses if incurred in connection with real estate located outside of Minnesota: option income or expenses, exploring, securing, and developing the real estate, and equipment used on the real estate.

The basis of tangible property acquired while a Minnesota resident and which is utilized in a trade or business outside of Minnesota shall be cost less depreciation allowable for Minnesota income tax purposes. However, prior to 1978, a Minnesota resident need not reduce the basis of out of state property

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which was held while a Minnesota resident. The amount of depreciation allowable in any year is the amount claimed in arriving at federal adjusted gross income and would not be modified because of a higher Minnesota basis. When property is utilized in a trade or business outside of Minnesota and is held by a Minnesota resident who acquired the property prior to the date of becoming a Minnesota resident, the federal adjusted basis of that property shall be the Minnesota basis.

3. The income or losses from a business located outside of Minnesota.

4. Income or losses from trusts, estates, partnerships, joint ventures, or Minnesota electing small business corporations to the extent that the income results from business conducted or tangible property located outside of Minnesota.

5. Income or losses from intangible assets owned by a Minnesota resident is not out of state income. Generally an intangible asset is a legal relationship between persons (which in fact has no geographic location) and is so associated with the owner that it is taxable at the place of the owner's domicile. The following is a listing of some intangible assets and includes the income or losses from these assets:

a. Stocks, notes and bonds even if secured by liens on property.

b. The right to receive payments under a contract for deed or mortgage.

c. The right to withdraw contributions to a retirement fund.

d. Dividends received.

e. Gains or losses from the sale or exchange of stocks, bonds or notes.

f. Interest received on a savings account.

g. Distributions received from a corporation which has made a federal election to be treated as a small business corporation but which has not made a similar election for Minnesota.

E. The amount of a net operating loss that may be carried back or carried forward shall be the same dollar amount allowed in the determination of federal adjusted gross income. However, as provided in Part C., no deduction is allowed for or with respect to that portion of losses which constitute tax preference items. An adjustment must also be made for any changes in the computation of federal adjusted gross income which have not been adopted by the Minnesota legislature in a law updating the reference to the Internal Revenue Code. A net operating loss shall be allowed to be carried back or carried forward only to the extent that loss was assignable to Minnesota in the year the loss occurred or in the year to which the loss was carried, which-

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ever would allow more of the loss to be allowed for Minnesota purposes. An individual who is a nonresident in the loss year and a resident in the carryover year or an individual who was a resident in the loss year and a nonresident in the carryover year should use this part to determine the amount of their net operating loss.

The taxpayer may also make an adjustment for gains or losses which result from the sale or other disposition of property having a higher adjusted basis for Minnesota income tax purposes than for federal income tax purposes subject to the limitations contained in § 290.01, subd. 20(b)(2) and (4). A taxpayer may make an adjustment to federal adjusted gross income for the modifications that affect shareholders of a small business corporation which has made an election for federal purposes but not for Minnesota purposes as provided in § 290.01, subd. 20(c).

The net operating loss carryback or carryover applied as a deduction in the taxable year to which the net operating loss is carried back or carried over shall be equal to the net operating loss carryback or carryover applied in the taxable year in arriving at federal adjusted gross income subject to the following modifications:

1. Increase the amount of carryback or carryover applied in the taxable year by the amount of losses and expenses not assignable to Minnesota incurred in the taxable year.

2. Decrease the amount of carryback or carryover applied in the taxable year by the amount of income not assignable to Minnesota earned in the taxable year and the amount of federal jobs credit or WIN credit earned in the taxable year.

3. A taxpayer who is not a resident of Minnesota during any part of the taxable year and who has no income assignable to Minnesota during the taxable year shall apply no net operating loss carryback or carryover in the taxable year.

The net operating loss carryback or carryover to the next consecutive taxable year shall be the net operating loss carryback or carryover as calculated in this Part less the amount applied in the taxable year(s) as above. No additional net operating loss carryback or carryover shall be allowed if the entire amount has been used to offset Minnesota income in a year earlier than was possible on the federal return. A net operating loss carryback or carryover that was allowed to offset federal income in a year earlier than was possible on the Minnesota return shall still be allowed to offset Minnesota income but only if the loss was assignable to Minnesota in the year the loss occurred.

F. To the extent a capital loss carryover is allowed in determining the federal adjusted gross income, the capital loss carryover will be allowed in Minnesota even though the capital loss was incurred on the sale of out of state property prior to 1978. However, see the special rules for husband and wife returns contained in Part J. of § 1.6002.

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13 MCAR § 1.6004 Minnesota gross income for individuals who are part year residents or nonresidents of Minnesota (Federal Adjusted Gross Income) *(Effective date 6/30/81)*

A. Gross income.

1. An individual who was a part year resident or a nonresident of Minnesota should use the appropriate federal adjusted gross income that was computed for federal income tax purposes as the beginning point in the determination of Minnesota gross income.

2. Modifications should be made to remove:

a. Income from personal and professional services performed outside of Minnesota,

b. other income from intangible assets, and

c. income and losses from tangible property located outside of Minnesota, which income or loss was received or earned while that person was a nonresident of Minnesota. After removing capital gains and losses not assignable to Minnesota, the taxpayer shall recompute the amount of capital gains that are included in Minnesota gross income. The taxpayer shall also recompute any capital loss limitation and capital loss carryover to remove those amounts that are not assignable to Minnesota.

A modification should also be made to remove the amount of certain qualified pension payments which are received while a nonresident of Minnesota.

A part year resident would apply these modifications and this rule to the income and losses received during that part of the year the individual was a nonresident of Minnesota. Income and losses received during that part of the year the individual was a resident of Minnesota would be governed by the rule concerning full year residents.

3. The following types of income received by a nonresident in Minnesota are to be included in that individual's Minnesota gross income and are assignable to Minnesota:

a. Wages, salaries, tips, fees, commissions, bonuses, or similar earnings for personal or professional service performed within Minnesota. Two conditions must be met before a taxpayer's income can be deemed personal or professional service income. First, the income producing activity itself must be the rendition of personal or professional services; and, second, the taxpayer must personally render such services; it is not enough to employ others to render them. The following are some examples of taxpayers who may be deriving income or earnings from the performance of personal or professional services: carpenter, plumber, bricklayer, repairman, barber, beautician, accountant, attorney, doctor, dentist, architect, engineer, or an insurance agent. While the ownership and management of a shopping center or

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hotel which furnishes business space is business income, it is not a personal service business.

b. Rents, royalties and any other income received from land, buildings, machinery, or other tangible property located in Minnesota.

c. Gains or losses from the sale or other disposition of land, buildings, machinery, or other tangible property located in Minnesota.

d. Business income or losses.

(1) Income or losses from

(a) a business,

(b) a farm,

(c) that portion of the distributive share of income or losses of a partnership which are attributed to Minnesota, and

(d) that portion of the distributed and undistributed net income or loss, which is attributed to Minnesota, of a small business corporation which has elected to be taxed as a partnership for Minnesota purposes, which income or loss is derived from the operation of a business in Minnesota or which is income or loss from tangible property located within Minnesota is assignable to Minnesota.

(2) Business conducted within Minnesota and which has a nexus within Minnesota so that the business is subject to Minnesota income tax would include income or losses from sales within Minnesota and a business dealing in personal and professional services where such services were performed in this state. Trade or business income or loss assignable to Minnesota and earned by a nonresident individual as a proprietorship or partnership which was carried on partly within and partly without Minnesota is subject to the three-factor apportionment formula contained in § 290.19 or apportionment under § 290.20 except for construction business on which the three-factor formula is not permitted. A nonresident individual who has farm income from within Minnesota and from outside of Minnesota may also use the apportionment formulas contained in §§ 290.19 and 290.20.

B. The definition of federal adjusted gross income is the same definition as is used for Minnesota residents and which is determined by the legislature by adopting the reference to the Internal Revenue Code for use in or application to that particular taxable year.

C. Income received by a nonresident, which is the distributive share of partnership income from personal or professional services which are performed in Minnesota, is assignable to Minnesota in the same proportion as the partnership income is assignable to Minnesota even though the nonresident partner performed no personal or professional services in Minnesota during that year.

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D. Minnesota gross income for a nonresident of Minnesota does not include income that is received as compensation for military or naval services performed within Minnesota.

E. The United States Government has entered into numerous tax treaties with different nations which provide that when a nonresident alien is employed in the United States the gross income which they earn is not subject to taxation in the United States as long as that nonresident alien is employed only temporarily in the United States. Since that income is not taxable for federal purposes, it would not be taxable for Minnesota purposes. Each tax treaty has somewhat different terms and each case must be examined on its own.

F. Minnesota gross income does not include personal or professional service income earned in Minnesota by a resident of Wisconsin or North Dakota who customarily returns at least once a month to their residence in that state. Wisconsin and North Dakota are the only two states that have reciprocity exclusion agreements with the state of Minnesota. The income subject to reciprocity exclusion is compensation for the performance of personal or professional services which the taxpayer personally renders. It is not enough to employ others to render these services.

1. The reciprocity exclusion does not apply where the personal or professional service income is earned as part of a business operated by the taxpayer which has employees that do more than incidental duties for the business or where there is the sale or delivery of goods which are more than an incidental part of the business. The reciprocity exclusion does apply to all the personal or professional income earned in the business where the sale of goods and the services of the employees are incidental. Where a partner is a member of a partnership where the selling of goods or the services of employees is more than incidental to the partnership business, reciprocity exclusion would apply only to the partner's salary (personal or professional service income) but not the distributive shares of the partnership business. Salaries would be subject to a reasonableness test and a provision for salaries must be part of the partnership agreement. If there is no written partnership agreement, or if in the written agreement no salary or salary formula is specifically provided, the payment to the partners is a partnership distribution and is not subject to reciprocity exclusion. Partnership draw does not constitute a salary; it is a convenience to the partners in withdrawing a share of their business equity. If all partners are performing personal services and the sale of goods and the services of the employees are incidental, the reciprocity exclusion applies to the partner's salary and to the partner's distributive share. The imputed income of a shareholder of an electing small business corporation (Subchapter S) is not subject to reciprocity exclusion as this income is in the form of a partnership distribution.

2. The word "incidental" means the sale of goods or the services of employees which are only a minor or secondary contribution to the personal service income of the individual or partnership for whom performed. The sale of goods or the services of employees is incidental if:

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a. for the sale of goods the gross profit (gross receipts less cost of goods sold) or

b. for the services of employees the total compensation paid the employees is less than $20,000 or 10% of the gross profit of the business, whichever is greater. The total compensation paid the employees and the gross profit from the sale of goods must be totaled when determining if the goods and employees are incidental.

3. If an individual's total income assignable to Minnesota is subject to reciprocity exclusion, that individual need not file a Minnesota income tax return. However, if that individual has Minnesota income, some of which is subject to reciprocity exclusion and some of which is not subject to reciprocity exclusion and if the income which is not subject to reciprocity exclusion exceeds the filing requirements for filing a Minnesota income tax return, that individual must file a Minnesota income tax return. That individual should use the appropriate federal adjusted gross income for the taxable year. A subtraction would be allowed at a subsequent point on the return to remove income which is subject to reciprocity exclusion.

In order to claim the reciprocity exclusion, individuals should file Form M-115, which is an affidavit claim for exemption of compensation received for services performed under the reciprocity exclusion. Although the exact form may change, the following information will be required:

a. Name, address, and social security number of the individual,

b. year for which the affidavit is being submitted,

c. amount of income received for services performed in Minnesota subject to reciprocity exclusion,

d. a statement whether or not Minnesota income tax was withheld on that income,

e. the name and address of the employer,

f. type of services performed in Minnesota,

g. state in which the individual maintains residence,

h. the year in which the individual became a resident of the state,

i. a statement disclosing whether or not the individual customarily returns to his residence in the other state at least once a month,

j. a statement whether or not the individual filed an income tax return with that state and whether the income subject to reciprocity exclusion was declared on that return and

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k. a statement declaring if the individual ever was a resident of Minnesota and, if so, when was the date of last residence.

An individual whose income is subject to reciprocity exclusion may also want to complete a withholding exemption certificate, Form MW-6.

G. The following items of income received by a nonresident are assignable to Minnesota regardless of the time or place received by the taxpayer if the underlying services giving rise to the payment were performed in Minnesota.

1. A bonus.

2. Commissions.

3. Vacation pay.

However, certain qualified pension payments are not assignable to Minnesota if they are received by a nonresident, even though the payments are attributable to services previously performed in Minnesota.

H. The amount of a net operating loss that may be carried back or carried forward shall be the same dollar amount allowed in the determination of federal adjusted gross income. Adjustments must be made in the net operating loss for income and losses which are not assignable to Minnesota and for any changes in the computation of federal adjusted gross income which have not been adopted by the Minnesota legislature in a law updating the reference to the Internal Revenue Code. A taxpayer may make an adjustment to federal adjusted gross income for the modifications that affect shareholders of a small business corporation which has made an election for federal purposes but not for Minnesota purposes as provided in § 290.01, subd. 20(c).

The net operating loss carryback or carryover applied as a deduction in the taxable year to which the net operating loss is carried back or carried over shall be equal to the net operating loss carryback or carryover applied in the taxable year in arriving at federal adjusted gross income subject to the following modifications:

1. Increase the amount of carryback or carryover applied in the taxable year by the amount of losses and expenses not assignable to Minnesota incurred in the taxable year.

2. Decrease the amount of carryback or carryover applied in the taxable year by the amount of income not assignable to Minnesota earned in the taxable year and the amount of federal jobs credit or WIN credit earned in the taxable year.

3. A taxpayer who is not a resident of Minnesota during any part of the taxable year and who has no income assignable to Minnesota during the taxable year shall apply no net operating loss carryback or carryover in the taxable year.

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The net operating loss carryback or carryover to the next consecutive taxable year shall be the net operating loss carryback or carryover as calculated in this Part less the amount applied in the taxable year(s) as above. No additional net operating loss carryback or carryover shall be allowed if the entire amount has been used to offset Minnesota income in a year earlier than was possible on the federal return. A net operating loss carryback or carryover that was allowed to offset federal income in a year earlier than was possible on the Minnesota return shall still be allowed to offset Minnesota income.

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13 MCAR S 1.6007 Subtraction for interest on United States government obligations. Minnesota Statutes, section 290.01, subdivision 20, clause (b)(1) allows an individual taxpayer, an estate, or a trust to subtract the amount of interest earned on certain obligations of the United States government from federal adjusted gross income. To qualify for this subtraction, the obligation must meet the following conditions:

A. The interest income on the obligation must have been included in federal adjusted gross income for the taxable year that the subtraction is claimed. If only a portion of the interest income on an obligation has been included in federal adjusted gross income, only the included portion may be subtracted.

B. The obligation must be an obligation of the United States of America, whether through an agency, authority, commission, or instrumentality of the United States, and must be exempt from state taxation under federal law. This means that the full faith and credit of the United States must be pledged to the payment of the underlying obligation.

C. The obligation must be in writing, bear interest, contain a binding promise by the United States to pay specified sums on specified dates, be specifically authorized by Congress, and be supported by a pledge of full faith and credit of the United States. Open accounts and other unsettled claims or demands are not obligations of the United States for purposes of this subtraction.

D. The obligation must be a direct and primary obligation of the United States. If the primary obligor is not the United States and the United States is merely an insurer or guarantor and has only a secondary or contingent liability, the interest income is not exempt. If the primary obligor is not the United States but the United States pays all or part of the interest on the obligation, the interest income is not exempt. If the obligation was originally a private obligation and if the obligee later gives up all rights against the original obligor as part of an insurance endorsement or otherwise, and agrees to look only to the United States for payment of both principal and interest, then the obligation has become a primary obligation of the United States and the interest income from it is exempt from state taxation.

E. Exhibits.

1. Rule 13 MCAR S 1.6007 E., exhibit I contains a list of securities that have been determined to be exempt from Minnesota income tax and for which a subtraction is allowed.

2. Rule 13 MCAR S 1.6007 E., exhibit II contains a list of securities that have been determined to be taxable by the State of Minnesota and for which no subtraction is allowed.

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3. Rule 13 MCAR S 1.6007 E., exhibits III and IV contain lists of various federal agencies or related organizations that either generally issue exempt obligations or generally issue taxable obligations. These lists are not intended to be conclusive on the taxable status of any particular obligation issued by or in conjunction with a listed agency or organization. Even though a listed agency generally only issues either exempt obligations or taxable obligations, it does not follow that each and every obligation carrying the name of that particular agency is either exempt or taxable. An agency may issue its own obligations that are exempt and also may handle private obligations that are not exempt. For example, the agency may administer, purchase and sell, insure, or guarantee an otherwise private obligation. Such action by the agency does not convert a private obligation into a direct and primary obligation of the United States of America and, therefore, does not make the private obligation tax exempt. The taxable status of each obligation must be determined separately in accordance with A.-D.

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13 MCAR S 1.6007 E., EXHIBIT I

Exempt Obligations Listed by Name of Security

	Name of Security	Agency	Authority as amended through 1-1-82
1.	Banks for Cooperatives bonds	Banks for Cooperatives	12 USC S 2134
2.	Farmers Home Administration notes, as defined in Tobak v. Commissioner	Farmers Home Administration	31 USC S 742, Tobak v. Commissioner, docket number 2244 Minn. tax court (March 10, 1977)
3.	Consolidated collateral trust debentures	Federal Intermediate Credit Banks	12 USC S 2079
4.	Consolidated discount notes	Federal Home Loan Banks	12 USC S 1433
5.	Consolidated Federal Home Loan Bank notes	Federal Home Loan Banks	12 USC S 1433
6.	Consolidated Federal Farm Loan bond	Federal Land Banks	12 USC S 2055
7.	Federal Farm Credit Banks consolidated systemwide bonds and notes	Federal Land Banks, Federal Intermediate Credit Banks	12 USC SS 2055, 2079, and 2134
8.	U.S. freedom shares	U.S. Treasury Department	31 USC SS 742, 753, and 757c
9.	U.S. savings bonds	U.S. Treasury Department	31 USC SS 742, 753, and 757c
10.	U.S. Treasury bills	U.S. Treasury Department	31 USC SS 742, 753, and 757c
11.	U.S. Treasury bonds	U.S. Treasury Department	31 USC SS 742, 753, and 757c
12.	U.S. Treasury certificates of indebtedness	U.S. Treasury Department	31 USC SS 742, 753, and 757c
13.	United States notes	U.S. Treasury Department	31 USC SS 742, 753, and 757c

13 MCAR S 1.6007 E., EXHIBIT II

Taxable Obligations Listed by Name of Security

Name of Security	Agency	Authority as amended through 1-1-82

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1.	Certificate of beneficial interest (CBI's)	Export-Import Bank of the U.S. (Eximbank)	12 USC SS 635 and 635d
2.	Eximbank debentures	Export-Import Bank of the U.S. (Eximbank)	12 USC S 635
3.	Participation certificates (PC's)	Export-Import Bank of the U.S. (Eximbank)	12 USC S 635
4.	Federal Assets Financing Trust participation certificates	Government National Mortgage Association (GNMA)	12 USC SS 1717(c) and 1721
5.	Federal Assets Liquidation Trust participation certificates	Government National Mortgage Association (GNMA)	12 USC SS 1717(c), 1721, and 1723 c
6.	GNMA mortgage-backed bonds	Government National Mortgage Association (GNMA)	12 USC SS 1717(c) and 1721
7.	GNMA pass-through securities	Government National Mortgage Association (GNMA)	12 USC SS 1717(c) and 1721
8.	Government Mortgage Liquidation Trust participation certificates	Government National Mortgage Association (GNMA)	12 USC SS 1717(c) and 1721
9.	National Government Securities Trust	Government National Mortgage Association (GNMA)	12 USC SS 1717(c) and 1721
10.	Mortgage participation certificates (PC's)	Federal Home Loan Mortgage Corporation	12 USC SS 1452(d) and 1455
11.	Guaranteed mortgage certificates (GMC's)	Federal Home Loan Mortgage Corporation	12 USC SS 1452(d) and 1455
12.	New communities debentures	Privately issued under HUD program	42 USC SS 3902 and 4514
13.	Certificate of beneficial ownership (CBO's)	Farmers Home Administration	7 USC SS 1922-1928
14.	SBIC debentures	Small Business Investment Companies	15 USC S 687(e)

13 MCAR S 1.6007 E., EXHIBIT III

Agencies Which Generally Issue Exempt Obligations

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NOTICE: This listing is only a guide and is not conclusive on the issue of the taxable status of an obligation. Each obligation issued by a listed agency must be separately analyzed according to A.-D.

	Name of Instrumentality	Types of Securities	Authority as amended through 1-1-82
1.	Bank for Cooperatives	Notes, debentures, and other obligations issued by the instrumentality	12 USC S 2134
2.	Commodity Credit Corporation	Bonds, notes, debentures, and other similar obligations	15 USC S 713a-5
3.	Federal Deposit Insurance Corporation	All notes, debentures, bonds, or other obligations	12 USC S 1825
4.	Federal Farm Credit Administration	Obligations	12 USC SS 2055, 2079, 2134, and 2098
5.	Federal Home Loan Banks	Notes, debentures, bonds, and other obligations issued by the bank	12 USC S 1433
6.	Federal Intermediate Credit Banks	Notes, bonds, and debentures issued by the instrumentality	12 USC S 2079
7.	Federal Land Bank Associations	Notes, bonds, debentures, and other obligations issued by the instrumentality	12 USC S 2055
8.	Federal Land Banks	(a) Mortgages held by the instrumentality	12 USC S 2055
		(b) Notes, bonds, debentures, and other obligations issued by the instrumentality	12 USC S 2055
9.	Federal Savings & Loan Insurance Corporation	All notes, debentures, bonds, or other obligations	12 USC S 1725(e)
10.	General Insurance Fund of the Dept. of Housing and Urban Development, including	Debentures	
	(i) Rental Housing Insurance		(i) 12 USC S 1713(i)
	(ii) Rental Housing Project		(ii) 12 USC S 1747g(g)
	(iii) War Housing		(iii) 12 USC S

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	Insurance			1739(d)
(iv)	Armed Services Housing		(iv)	12 USC S 1748b(f)
(v)	National Defense Housing Insurance		(v)	12 USC S 1750c(d)
(vi)	Neighborhood Conservation Housing Insurance		(vi)	12 USC S 1715k (h)(7)
11.	Panama Canal bonds	Bonds		31 USC SS 744 and 745
12.	Production Credit Associations	Notes, debentures, and other obligations issued by the instrumentality		12 USC S 2098
13.	Puerto Rico	Bonds		48 USC S 745
14.	Tennessee Valley Authority	Bonds		16 USC S 831n-4(d)
15.	U.S. Postal Service	Obligations		39 USC S 2005(d)(4)
16.	Virgin Islands	Bonds		48 USC S 1574

13 MCAR S 1.6007 E., EXHIBIT IV

Organizations Which Generally Issue Taxable Obligations

NOTICE: This listing is only a guide and is not conclusive on the issue of the taxable status of an obligation. Each obligation issued by a listed agency must be separately analyzed according to A.-D.

	Name of Organization	Types of Securities	Authority as amended through 1-1-82
1.	Asian Development Bank	Obligations	22 USC SS 285-285t
2.	District of Columbia Armory Board	Obligations	31 USC S 742a(a)
3.	Environmental Financing Authority	Obligations	33 USC S 1281 note, P.L. 92-500 S 12(j)
4.	Export-Import Bank	Notes, debentures, bonds, or other obligations	12 USC SS 635-635n

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5.	Farmers Home Administration	Obligations	7 USC SS 1922-1928
6.	Federal Home Loan Mortgage Corporation	Obligations	12 USC S 1455
7.	Federal National Mortgage Association (FNMA)	Obligations, mortgage-backed securities, subordinated obligations, participation certificates (PC's)	12 USC S 1719(e)
8.	Government National Mortgage Association (GNMA)	Obligations, mortgage-backed securities, participation certificates (PC's)	12 USC SS 1717(c), 1721, and 1723c
9.	Inter-American Development Bank	Obligations	22 USC SS 283-283z
10.	International Bank for Reconstruction and Development (World Banks)	Obligations	22 USC SS 286-286r
11.	International Monetary Fund	Obligations	22 USC SS 286-286r
12.	Maritime Administration, Merchant Marine	Private obligations guaranteed by agency	46 USC S 1273
13.	National Consumer Cooperative Bank	Obligations	12 USC S 3017(d)
14.	New community development corporations	Bonds, debentures, notes, and other obligations issued on behalf of private new community developers and state land development agencies which are guaranteed by HUD	42 USC SS 3902 and 4514
15.	Small Business Investment Companies	Debenture bonds, promissory notes, and other obligations	15 USC S 687(e)
16.	Washington Metropolitan Area Transit Authority (WMATA)	Bonds	40 USC SS 651-671
17.	Federal Financing Bank	Obligations issued by the bank	12 USC S 2283 and 31 USC S 742
18.	Federal Reserve banks	Obligations	12 USC S 502 and 12 USC S 531
19.	Student Loan Marketing Association	Bonds and notes	20 USC S 1087-2

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Repealed 85R 1079 11-7-83

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13 MCAR S 1.6016 Individual housing accounts.

A. Definitions.

1. IHA. The term "IHA" shall mean an individual housing account established pursuant to this rule and the Young Family Housing Act.

2. Participant. The term "participant" shall mean an individual natural person for whose exclusive benefit an IHA is held. In the case of an IHA held jointly for an individual and his or her spouse, the term shall mean both of them.

3. Deposit. The term "deposit" shall mean a deposit or contribution of cash to an IHA, whether made by the participant or any other person.

4. Withdrawal. The term "withdrawal" shall mean a withdrawal or distribution of any amount from an IHA, whether withdrawn by or distributed to the participant or any other person or entity.

5. Principal residence. The term "principal residence" shall mean the dwelling unit that the participant actually lives in and that the participant intends to be his/her fixed abode. A principal residence shall require both a physical presence in the dwelling unit and an intention to make that dwelling unit one's home. A principal residence shall be that dwelling unit to which, during an absence, the participant intends to return and from which there is no present intention of moving. There shall be a presumption that the dwelling unit in which a person's family lives is that person's principal residence.

The dwelling unit must be located within Minnesota and may be all or part of a house, townhouse, condominium or cooperative. If a building contains more than one dwelling unit, only the dwelling unit actually occupied by the participant as his/her residence shall qualify as a residence. If a portion of the building is used for some purpose other than as a dwelling unit, for example, a portion of a building is used for a trade or business, only the portion used as a dwelling unit shall be considered a residence. The purchase price of such a building shall be properly allocated between the dwelling unit and the business portion of the building.

The participant may purchase the residence with others, for example, in joint tenancy, tenancy in common, or as a tenant-stockholder in a cooperative housing corporation. In this case, the dwelling unit shall qualify as a residence only to the extent of the participant's ownership interest therein.

In order to qualify for any of the benefits of the IHA provision, the residence must be the first dwelling unit ever owned and occupied by the participant as his/her own permanent residence. A taxpayer who previously owned or currently owns

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his/her own residence, whether located in Minnesota or in any other state or country, shall not qualify.

B. General requirements.

1. An IHA shall be a trust established in Minnesota for the exclusive benefit of a participant or, in the case of a married person, for the exclusive benefit of the participant and the participant's spouse, jointly.

2. An IHA shall not be established or maintained for a participant who currently owns or formerly owned a principal residence, whether or not it is (was) located in Minnesota.

3. An IHA shall not be established or maintained for a participant who is currently the participant of another IHA. An individual shall not have two IHAs at one time. However, an IHA may be established for an individual who had an IHA at some time in the past but which was terminated and not used for the purchase of a first principal residence.

4. Contents of trust agreement. (For recommended format of trust agreement, see exhibit A.) The IHA trust shall be established pursuant to a written trust agreement which shall contain, in addition to any other provisions, a separate provision for each of the trustee's duties prescribed in part C. of this rule and a statement that the trustee agrees to comply with the law and rules applicable to IHAs.

5. Contents of disclosure statement. (For recommended format of disclosure statement, see exhibit B.)

a. The disclosure statement shall set forth in nontechnical language the income tax consequences of establishing an IHA, the limitations and restrictions on the program, and other matters as follows:

(1) The ineligibility of individuals who own or have owned a residence;

(2) The deductibility of deposits to an IHA, the $1,500, $2,500 and $10,000 maximum limitations, and the requirement that the amount be on deposit for six months before a deduction is allowed;

(3) The tax treatment of a withdrawal from an IHA when the amount withdrawn is used for any purpose other than the purchase of a first principal residence that is located in Minnesota;

(4) The requirement that the first principal residence be purchased within ten years from the date that the account was first established;

(5) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on withdrawals

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Repealed 8SR 1079 11-7-83

not used for the purchase of a first principal residence.

(6) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on excess contributions as well as an explanation of what constitutes an excess contribution.

(7) The availability of a tax free transfer of the account to a different financial institution or credit union and an explanation of what constitutes such a transfer.

(8) If the IHA is revocable within seven days after establishment, as provided in subpart C.1.f., the disclosure statement shall include a statement of the circumstances under which the participant may revoke the account and the procedure therefor, including the name, address and telephone number of the person designated to receive the notice of revocation. This explanation shall be prominently displayed at the beginning of the disclosure statement.

(9) A statement that the trustee is authorized by law to act as trustee of IHAs and has received approval to so act from the commissioner of banks or is not required to obtain such approval.

(10) A statement that the trustee will abide by all laws and rules applicable to trustees of IHAs.

(11) A statement that it is the participant's responsibility to assure that the financial institution is authorized by law to act as trustee of IHAs and that the particular account set up for that participant meets all of the requirements of the law and this rule.

(12) A statement that upon audit of the participant's income taxes by the Department of Revenue, if it is found that the account or the trustee do not meet all of the requirements of the law and this rule, the deductions under this program may be denied.

b. If the trustee does not furnish a disclosure statement as required by this rule or furnishes one that does not substantially comply with this rule, he shall be liable to the commissioner for a penalty of $10 for each required disclosure statement that he did not furnish or that did not comply with this rule. A disclosure statement that is false or misleading shall not be considered to comply with this rule.

6. A financial institution or credit union may act as the trustee of of IHAs only if it meets the requirements of the law and this rule and either it has received approval to so act from the commissioner of banks or it is not required to obtain such approval.

7. A financial institution or credit union, in order to act as a trustee of IHAs, must actively make residential real

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estate mortgage loans in Minnesota. This means that the particular financial institution or credit union must originate mortgage loans in Minnesota on Minnesota real estate by lending money to the original mortgagor and taking a mortgage back as security for the loan. The mere holding of Minnesota mortgages, obtained in the secondary market by an institution that does not originate such loans, does not qualify.

Furthermore, the institution shall, subject to the availability of funds for such purpose, regularly throughout the year be ready and willing to make residential real estate mortgage loans in Minnesota. Whether or not an institution is actively engaged in making such loans shall be determined by reference to the general market conditions affecting all real estate mortgage lenders, rather than by the actual number of such mortgage loans made by the particular institution during a particular period of time. The fact that there is no mortgage money available or that the interest rate is so high that no one desires a mortgage loan shall not, alone, prevent a financial institution from being a trustee. The fact the institution seeking approval to administer IHAs made no such loans during a period of time while other financial institutions were making such loans shall be evidence that the particular financial institution is not actively making residential real estate loans in Minnesota.

8. The participant shall, upon request of the commissioner, submit copies of the trust agreement and disclosure statement and such other evidence as the commissioner may request to establish whether or not the particular IHA meets the requirements of the law and this rule. None of the tax benefits of the IHA provisions shall be available to a participant who is unable to show that both the IHA and the trustee meet the requirements of the law and this rule.

C. Duties of trustee.

1. In general.

a. The trustee shall accept only cash deposits to an IHA. No other property shall be accepted in an IHA trust, such as stocks, bonds, notes, debentures, mutual funds, real estate, or otherwise.

b. The trustee shall not accept deposits to an IHA in excess of $2,500 for a single taxable year or in excess of $10,000 for all taxable years.

c. The trustee shall not establish an IHA for an individual unless he receives a written statement from the individual indicating that the individual does not currently own and has never owned his/her own principal residence, whether in Minnesota or in any other state or country.

d. The trustee shall distribute the entire account to the participant within ten years after the first deposit to the

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account. Transfer of the entire amount in the IHA into a different account, which is not an IHA, shall constitute such a distribution but the transfer shall be treated as a withdrawal not used for the purchase of a first principal residence, as provided in part F. of this rule, and the trustee must withhold tax as prescribed by subpart 3. of this part.

e. For each withdrawal, the trustee shall withhold tax as prescribed by subpart 3. of this part unless it verifies in accordance with this rule that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota and makes the instrument of payment payable to the seller or the seller's designee (other than the participant), construction contractor or other vendor of the property. If only a portion of the withdrawal will be used for the purchase of a first principal residence, tax shall be withheld on the portion that will not be so used. This subparagraph is not applicable to a withdrawal attributable to disability or death which is verified in accordance with this rule.

f. The trustee at least seven days prior to the establishment of an IHA shall provide a written disclosure statement in accordance with this rule and a copy of the governing instrument to each person who proposes to establish an IHA with the trustee. In the alternative, the trustee may provide the written disclosure statement to the participant at the time that the IHA is established, but only if the trust agreement provides that the trust shall not constitute an IHA for seven days following execution of the agreement, during which period of time the grantor may revoke the trust.

g. In the case of an amendment to the terms of the account or trust agreement, whether or not made pursuant to a statutory or rule change, a revised disclosure statement shall be furnished to the participant. The revised statement need not repeat material furnished in a prior statement, but it must set forth those matters affected by the amendment.

h. The trustee may invest assets of the trust only in savings or time deposits. Certificates of deposit shall qualify as savings or time deposits. The savings or time deposits must be the trustee's own accounts or certificates; investment in accounts or certificates of other institutions is not permitted. The savings or time deposits must be fully insured by an agency of the state or federal government. Assets of an IHA trust shall not be invested in any other types of assets, e.g., stocks, bonds, notes, debentures, mutual funds or otherwise.

i. The trustee may commingle funds held in IHA trusts for purposes of investment but the trustee shall maintain individual records on each IHA in accordance with this rule.

2. Reporting requirements.

a. Annual report to commissioner of revenue.

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(1) The trustee shall file a report with the commissioner of revenue by February 28 of each year for each IHA administered by him at any time during the preceding calendar year, including the following information on each IHA:

(a) Name, address, and such other identifying information of the trustee as the commissioner may prescribe.

(b) Name, address and social security number of the participant(s).

(c) Date account was established.

(d) Whether a withdrawal was used for the first purchase of a principal residence in Minnesota. If so, the trustee shall submit with this report the verification form required under subpart c. of this part.

(e) Whether a withdrawal was claimed to be attributable to death or disability. If so, the amount thereof shall be indicated and the trustee shall submit with this report the written declaration required under part H. of this rule.

(f) Date and amount of each deposit during the preceding calendar year.

(g) Date and amount of each withdrawal during the preceding calendar year.

(h) Amount of interest paid, accrued or credited to the account during the preceding calendar year.

(2) One copy of the report shall be filed with the commissioner of revenue; two copies shall be furnished to the individual participant.

b. Report and verification by trustee of withdrawals used for first principal residence in Minnesota.

(1) Before allowing a withdrawal from an IHA, the trustee shall either withhold tax as prescribed by paragraph 3., below, or verify that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota (unless the trustee determines in accordance with part H. that the account holder has died or become disabled). The verification shall be supplied on a form prescribed by the commissioner which is completed by the participant and filed with trustee. The following information shall be included on the form:

(a) Location and description of property being purchased.

(b) Name and address of person or entity from whom the property is being purchased.

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(c) Name of realtor, closing company, etc., if any.

(d) Type of ownership anticipated, i.e., whether title will be held alone, as tenancy in common, joint tenancy, or cooperative.

(e) Total purchase price, including any mortgages or contracts given or assumed.

(f) Amount to be financed, i.e., amount to be paid later than closing date, whether by mortgage, contract for deed or otherwise.

(g) Anticipated closing costs and description thereof.

(h) Closing date.

(i) Amount withdrawn from the account during the taxable year.

(j) Portion of amount withdrawn which will be used to purchase the first principal residence.

(k) The person or entity to whom the withdrawal or distribution is to be made payable.

(l) Name and address of trustee.

(m) Name, address and social security number of participant.

(2) The trustee shall file a copy of this form with the commissioner of revenue at the time that he files the annual information return for the particular account.

3. Withholding requirements.

a. The trustee shall withhold tax in an amount equal to ten percent of the amount of any withdrawal and remit the amount within ten days to the commissioner of revenue unless the trustee satisfies one of the following requirements:

(1) Verifies in accordance with this rule that the withdrawal is used for the first purchase of a principal residence located in Minnesota, and makes the withdrawal payable to the person or entity from whom the residence is being purchased, either alone or jointly with the participant, or

(2) verifies in accordance with this rule that the participant has died or is disabled, or

(3) determines that the withdrawal is of an excess contribution and is withdrawn by the due date of the tax return for the taxable year in which the excess contribution was made.

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b. The trustee shall be personally liable for the amount of any tax required to be withheld under this section.

4. Penalties. For each instance in which a trustee fails to timely file or furnish a report or return required by this rule with either the commissioner of revenue or with the individual participant, a penalty of $10 shall be due from the trustee and shall be paid to the Commissioner of revenue.

D. Deduction for contributions to an IHA.

1. The annual deduction for deposits to an IHA shall not exceed $1,500. Moreover, the total amount of all deductions for deposits to an IHA that may be claimed by the participant and his spouse in all taxable years shall not exceed $10,000. These limitations shall not apply to amounts deducted which constitute interest accrued on the IHA.

2. An additional deduction shall be allowed for interest accrued on the IHA during its ten year existence. However, no deduction shall be allowed for the portion of any interest which is attributable to an excess contribution, as defined in part G. of this rule. And, no deduction shall be allowed for interest paid or accrued after the termination of the IHA.

3. No deduction shall be allowed under the IHA provisions for any amounts which have already been excluded from gross income or deducted in computing taxable income whether under federal law or under another provision of state law. A taxpayer shall not deduct or exclude the same item twice. For example, if an unmarried participant excludes $200 of interest income, earned from an IHA, in computing federal adjusted gross income under the federal provision allowing a partial exclusion of dividend and interest income received by individuals, he cannot take a deduction for the same $200 of interest under the IHA provisions. If more than $200 of interest was credited to his IHA during the taxable year, he may deduct the excess over $200 under the IHA provisions.

4. To the extent that a deposit is deductible under this rule, no deduction shall be allowed for interest expense in connection with a loan the proceeds of which are deposited to the IHA.

5. The deduction shall be allowed only for amounts on deposit for at least six months at the close of the taxable year. For calendar year taxpayers, the deposit must have occurred prior to July 1 of the taxable year.

Amounts on deposit for less than six months at the close of the taxable year may be deducted only in the next succeeding taxable year and shall be included when determining the $1,500 maximum deduction amount for that next succeeding taxable year. Thus, a deduction not exceeding $1,500 is allowed for deposits to an IHA in the last six months of the preceding taxable year or in the first six months of the current taxable year.

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The deduction for interest paid or accrued on an IHA shall be allowed only for interest paid or accrued during the taxable year. Thus, for a deposit made during the last six months of a taxable year, the interest paid or accrued during the last six months of the taxable year shall be allowed as a deduction for that taxable year even though the deposit itself is not deductible until the next taxable year.

6. Married participants shall not each get a $1,500 deduction for each taxable year. The sum of the deductions, not including interest, allowed to the two married participants shall not exceed $1,500. This rule shall apply whether the married participants file separately on separate forms, separately on a combined form, or jointly.

For married participants who file separate returns, only the individual to whom the money that is deposited actually belongs shall be allowed the deduction. For married participants who file separate returns on a combined form or who file joint returns, the deduction shall be allowed to the spouse to whom the money that is deposited actually belongs or the deduction may be divided between them as they elect.

Married participants shall not each be allowed deductions totaling $10,000. Rather, the sum of all deductions, not including interest, claimed by the two married participants for deposits to an IHA for all taxable years shall not exceed $10,000. Any amount deposited in excess of $10,000 shall be treated as an excess contribution and subject to the six percent additional tax.

E. Exemption from tax for distributions used for a first residence.

1. Amounts withdrawn from an IHA which are used exclusively in connection with the first purchase of a principal residence in Minnesota shall not be included in gross income in the taxable year withdrawn.

2. The term "used exclusively in connection with the first purchase of a principal residence" shall mean only those amounts used for items directly related to the initial purchase of the participant's own first residence. In addition to the actual down payment, the term may include fees and other acquisition expenses incurred and actually paid by the participant for the first residence, such as sales commissions, points (those not deductible as interest), title insurance, legal fees, inspection fees, and current or delinquent real estate taxes; provided, however, that each item shall be included in this term only to the extent that the item is not deductible under another provision of state or federal law.

The term shall not include interest (or points, to the extent the points are deductible as interest), since interest is deductible under another provision of law. The term shall not include expenditures for repairs or maintenance of the residence

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which do not increase its value or extend its useful life, i.e., noncapital expenditures. Also, the term shall not include expenditures for personal property, such as furniture, appliances or other furnishings.

If the participant is building his own new residence or purchasing and remodeling an existing residence (or having a contractor do it for him or her), the term may include amounts paid for building materials and labor, as well as for the lot or the existing residence being remodeled.

In order to qualify as an amount "used exclusively in connection with the first purchase of a principal residence," the amount withdrawn shall be made payable to the person or entity from whom the property is being purchased. This may include the seller, vendor, contractor, or designee of one of them (other than the participant), or the person or entity from whom the building materials or labor are being purchased. The amount may be made payable to such person or entity, alone, or jointly with the participant.

Use of an amount from an IHA pursuant to a written earnest money agreement shall be considered as used for the first purchase of a principal residence, if all other requirements are met. If the sale is not completed and the money is either forfeited pursuant to the earnest money agreement or immediately redeposited in the IHA, no tax consequences shall result, i.e., the withdrawal for earnest money is ignored. However, if the earnest money is used for any other purpose, the amount withdrawn shall be treated as "not used for the purchase of a first principal residence," as provided in part F. of this rule. The trustee, however, is not required to withhold the ten percent additional tax on a withdrawal used for earnest money as long as the trustee makes the withdrawal payable to the escrow agent and obtains from the participant a completed verification that the withdrawal is being used for the purchase of a first principal residence.

3. In order to be exempt from taxation, the amounts shall be used for the purchase of the principal residence within a reasonable time after withdrawal and shall not be used for any other purpose in the interim.

4. Only the participant of the particular IHA may use the account for the purchase of his/her own first principal residence. It cannot be used to purchase a residence for someone else, for example, by gift, loan, or rental to another.

5. A participant shall not deduct or exclude the same item twice, under different provisions of law. For example, when the participant makes a withdrawal from an IHA and uses it for the first purchase of a principal residence, if any portion of the withdrawal is used to pay interest expense in connection with the purchase of the residence, no deductions shall be allowed for the portion so used, since interest expense is deductible under another provision of law.

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6. No adjustment to the basis of the residence that is purchased is required because of the use of amounts from an IHA.

7. A withdrawal used for the first purchase of a principal residence shall not be included in computing the low income alternative tax, the property tax refund, or in the income limitations for purposes of the homemaker credit, the dependent care credit, the farm loss modification, or the charitable deduction.

8. In order to claim exemption from income tax of amounts used for a first principal residence in Minnesota, the participant shall attach to his income tax return for the taxable year a copy of the verification form that he or she provided to the trustee as well as a copy of the closing statement, if any, from the purchase of the residence. The participant shall also furnish any additional information that the commissioner may request to verify that all requirements of this rule have been met.

F. Tax treatment of distributions not used for a first principal residence.

1. With certain limited exceptions, amounts withdrawn from an IHA which are not used for the purchase of a first principal residence, are includible in the participant's gross income and subject to an additional ten percent tax in the taxable year of the withdrawal. The additional tax is in addition to any tax that is otherwise due on the amount of any withdrawal that must be included in gross income.

2. The amount to be included in gross income is not necessarily the total amount of the withdrawal. Rather, the amount includible in gross income is the portion of the withdrawal attributable to a contribution or accrued interest that was actually deducted under the IHA provisions, either in the current or a prior taxable year. The portion of a withdrawal that is not attributable to either a deductible contribution or deductible interest is not includible in gross income or subject to the ten percent additional tax.

3. There is an exception to these rules where the participant has died or become disabled. The ten percent additional tax shall not be due from the estate of a participant who has died or from a participant who has become disabled if the death or disability is verified in accordance with part H. of this rule.

4. All amounts withdrawn and not used for the purchase of a first principal residence are ordinary income to the participant. The ten percent additional tax is not to be offset by any nonrefundable tax credits.

5. The ten percent additional tax shall not apply to a withdrawal of excess contributions where the withdrawal is made within the time for filing a return for the taxable year in

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which the excess contribution was made. This paragraph shall apply only if the interest attributable to the excess contribution is withdrawn at the same time.

6. The ten percent additional tax shall not apply to amounts returned to a prospective participant pursuant to a revocation of the trust within seven days of its establishment, as provided in part C.1.f. of this rule. Until the revocation period has expired, the account shall be treated as not constituting an IHA and the return of the initial deposit shall not be treated as a "withdrawal."

7. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

G. Excess contributions.

1. An additional tax shall be due from the participant of an IHA in which there are "excess contributions" on deposit. The additional tax shall be an amount equal to six percent of the amount of the excess contributions in the account.

2. The additional tax shall be due in the taxable year in which the excess contribution is made and in each taxable year that the excess contribution remains in the account. When excess contributions are made in more than one taxable year, the amount of the excess contributions made in the current taxable year shall be added to the amount of excess contributions remaining in the account from previous taxable years in determining the amount of the excess contributions subject to the additional tax.

3. "Excess contributions" are those amounts deposited in an IHA during a particular taxable year which exceed $2,500 or during the ten-year life of the IHA which exceed $10,000. However, an amount in excess of $2,500 deposited during a taxable year shall not be considered an excess contribution and shall not be subject to the six percent additional tax if the excess amount, together with the interest earned on the excess amount, is withdrawn from the account by the date that the tax return is due for the taxable year of the excess contribution. Thus, the six percent additional tax may be avoided by withdrawing the excess amount before the tax return is due. The interest earned on the excess contribution shall not be allowed as a deduction in the taxable year in which the contribution was made, or thereafter. The withdrawn contribution shall not be included in gross income except to the extent that any portion was deducted or otherwise not taxed in the year of the contribution.

4. An excess contribution may also be withdrawn in a year subsequent to the year in which the excess contribution was made. The six percent additional tax shall not be due on the

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amount of the excess contribution that was withdrawn before the close of the taxable year. There is no requirement that the interest earned on the excess contribution be withdrawn from the account with the excess contribution, as in the previous paragraph.

5. Any withdrawal from an IHA in which there are excess contributions on deposit shall be deemed a withdrawal of the excess contributions to the extent thereof. Thus, any withdrawal will reduce the amount subject to the excess contribution additional tax, yet will not reduce any allowable deduction or exemption to the extent of the excess contribution.

6. An excess contribution made in one taxable year may be used in another taxable year as a deductible contribution. An amount so used must be included with any deposits made in the current year in determining whether the deduction limitations of $1,500 and $10,000, provided in part D.1. of this rule, have been met. The deduction allowed for an excess amount in an IHA shall be the amount of the difference between the maximum amount allowable as a deduction and the amount that is actually deposited during the taxable year. A deduction shall not be allowed for an excess contribution in a taxable year prior to the year in which the excess contribution is made.

H. Special rules.

1. Disability or death.

a. A withdrawal by a participant who is disabled within the meaning of Minnesota Statutes, section 290A.03, subdivision 10 shall not be subject to the ten percent additional tax for not using it for the purchase of a first principal residence. The withdrawal shall, however, be included in the participant's gross income in the year of the withdrawal under the same rules as for a participant who is not disabled. A disabled participant shall be subject to the six percent additional tax on excess contributions.

A participant shall not be treated as disabled unless he furnishes to the trustee at or prior to the time of the withdrawal a signed declaration of his/her disability including a description of the disability, the name of his/her treating physician and a statement, signed by that physician, stating that the disability prevents the participant from engaging in any kind of substantial gainful work or that the participant is "blind" within the meaning of Minnesota Statutes, section 290A.03, subdivision 10. The trustee shall file a copy of this declaration with the commissioner of revenue. Upon request, the participant claiming disability shall furnish to the commissioner of revenue a signed statement of a physician describing in detail the nature of the disability and, except in the case of blindness, how it prevents the participant from engaging in any substantial gainful work. In addition, the individual shall furnish such other information as the commissioner shall determine is necessary to verify that the

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disability is within the meaning of Minnesota Statutes, section 290A.03, subdivision 10.

b. Except in the case of an account held jointly between spouses, upon the death of a participant of an IHA, the account shall terminate and become immediately payable to the estate of the deceased participant. The amount in the account as of the date of death, including any accrued interest, shall be treated as a withdrawal and included in the deceased participant's gross income on his/her final income tax return. The ten percent additional tax for failure to use a withdrawal for the purchase of a first principal residence shall not be applicable to the deceased participant or his/her estate.

In the case of an account held jointly for the benefit of two spouses, upon the death of one of the spouses, the account shall continue for the benefit of the surviving spouse. Limitations and restrictions on the IHA shall apply to the surviving spouse as if he or she had made all prior deposits and withdrawals. No additional tax shall be due solely by reason of the death. Also, no additional tax shall be due by reason of a withdrawal attributable to the death. A withdrawal by surviving spouse shall be deemed to be attributable to the death if it is made within six months after the death. Any other withdrawal, not attributable to the death, shall be subject to the additional tax if it is not used for the purchase of a first principal residence. Also, the surviving spouse shall remain subject to the additional tax on excess contributions.

2. Transfers of IHAs.

a. The term "transfer" shall mean a transfer of the entire amount in an IHA in one financial institution or credit union to a new IHA in another financial institution or credit union.

b. The participant of an IHA may transfer an IHA from one financial institution or credit union to another. The transfer of an IHA pursuant to this rule shall not be treated as a withdrawal from the first account or as a deposit to the second account as long as each of the requirements of this rule are met with respect to each account. The amount transferred pursuant to this rule shall not be included in gross income in the year of the transfer or subject to the ten percent additional tax for not being used for the purchase of a first principal residence in Minnesota. The six percent additional tax on excess contributions shall apply only if and to the extent that excess contributions are transferred as part of the account.

c. A transfer shall qualify under this rule only if the entire interest in the IHA is transferred to a new IHA and the original IHA is closed and terminated. A participant shall not have more than one IHA at any one time. The funds in an account to be transferred shall be promptly transferred from one financial institution or credit union to another. Any use of

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the funds for any purpose in the interim shall be treated as a withdrawal not used for a first principal residence and shall be included in gross income and subject to the additional tax.

d. The IHA account receiving the transfer shall terminate ten years from the date the original IHA account was established and the written trust agreement shall so provide. The participant shall inform the new trustee that the deposit is a transfer of the IHA, rather than a new IHA, and the date of the first deposit to the original IHA.

e. The trustee of the account to be transferred shall not be subject to the withholding requirements of this rule if it received a written declaration from the participant of his or her intention to roll over the account and the name and address of the financial institution or credit union to which the account will be transferred. The original trustee shall make the instrument of payment payable to the new trustee, either alone or jointly with the participant. The original trustee shall within ten days file a copy of the declaration with the commissioner of revenue.

3. Nonresidents. An individual who is not a resident of Minnesota shall be allowed to establish an IHA in Minnesota and shall be allowed a deduction for deposits to the account against any income that is assignable in Minnesota. A Minnesota resident who establishes an IHA but later changes his/her residence to another state may maintain the IHA in Minnesota.

A nonresident participant shall be subject to the same rules as a resident with respect to the includibility of withdrawals in gross income and the imposition of additional taxes. Any portion of a withdrawal that is required to be included in gross income shall be assignable to Minnesota. Any amounts upon which an additional tax is imposed shall be assignable to Minnesota.

4. Married participants. Whenever two single participants marry, their two accounts shall be treated for tax purposes as one joint account. This treatment, however, shall extend only to the two married participants and shall have no effect whatsoever on the trustees of either account, who shall continue to administer each account as if there was a single participant. Both accounts shall be treated as having terminated ten years from the date of the first deposit to the account that was established first. Only those deposits made in the taxable year of the marriage and thereafter will be considered in determining the excess contributions. The $1,500, $2,500 and $10,000 limitations shall apply separately to each participant for taxable years prior to the marriage and shall apply to the two participants together, the same as for other married participants, for the taxable year of the marriage and for all taxable years thereafter in which they are married. If, in the taxable year of the marriage, deposits made by both participants, together, total $10,000 or more, all further deposits shall be excess contributions subject to the six

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percent additional tax. Interest shall be deductible in the year of the marriage and thereafter only to the extent that it is attributable to the first $10,000 of total combined deposits.

The amounts in the two accounts prior to the tax year of the marriage shall not be considered an excess contribution in the year of the marriage solely because of the two accounts being treated as one.

For example, A set up an IHA in 1981 and deposited $1,500 per year to the account. B set up an IHA in 1981 and deposited $2,500 per year to the account. In 1985, A and B marry. A's account balance in 1985, not including interest or transactions in 1985, is $6,000. B's account balance in 1985, not including interest or transactions in 1985, is $10,000. Upon marriage, the two accounts will be treated as one account for tax purposes. The balance on the marriage date will be $16,000, not including interest. Because the total deposits by the two spouses exceed $10,000, no further deposits will be allowed. Any deposit made in 1985 or thereafter is an excess contribution subject to six percent additional tax. No additional tax shall be imposed for the year of the marriage as long as no deposits are made during that year or any that were made in 1985 are withdrawn by April 15, 1986. Interest will be deductible only to the extent it is attributable to the first $10,000 of deposits. Interest on the other $6,000 of deposits in the account is not deductible.

5. Termination of account.

a. The IHA shall terminate in the following cases:

(1) The account shall terminate whenever all or part of the account is used for the purchase of a first principal residence which is located in Minnesota. No deduction shall be allowed for deposits made or interest paid or accrued after the termination.

(2) The account shall terminate ten years from the date of the first deposit to the account. In the case of an IHA which has received a transfer from another IHA under part H.2. of this rule, the account shall terminate ten years from the date of the first deposit to the first account. All amounts in the account on the termination date shall be distributed to the participant. Transfer of the total amount in the IHA to an non-IHA account shall satisfy this distribution requirement. However, it shall be treated as a withdrawal not used for the purchase of a first principal residence.

b. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

6. Marriage dissolution transfers. A transfer of a

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participant's interest in an IHA to his former spouse pursuant to either a dissolution of marriage decree or a written instrument incident to a dissolution of marriage shall not be treated as a withdrawal and shall not be includible in gross income or subject to additional tax solely by reason of the transfer, as long as the IHA is maintained as such by the transferee. However, the withdrawal of any amounts from the IHA by the transferee shall be treated as any other withdrawal and subject to all of the provisions of this rule. Limitations and restrictions on the IHA shall apply to the transferee as if he or she had made all prior deposits and withdrawals. For example, if the transferee had deducted $9,000 for deposits to the account over a six year period prior to the marriage dissolution transfer, the transferee could deposit only $1,000 more before reaching the $10,000 deduction limitation. The IHA would automatically terminate four years after the transfer since the transferee is treated as having made the first deposit to the account six years prior to the transfer.

I. Exhibits

Exhibit A

PROTOTYPE

INDIVIDUAL HOUSING ACCOUNT

TRUST AGREEMENT

This agreement is entered into this ____ day of _____, 19__, between:
Individual's Name: _____
Spouse's Name: _____
(If married, both spouses must be listed.)
Social Security Numbers: ___ __ ____ and ___ __ ____
Address: _____
_____
hereafter referred to, singularly and collectively, as "Participant," and
Name of Financial Institution: _____
_____
Banking Division's Approval Number: _____
(If none is required, so indicate.)
hereafter referred to as "Trustee,"
For the purpose of establishing a trust which qualifies as an Individual Housing Account under Minnesota Statutes, section 290.09, subdivision 30 (also referred to as the Young Family Housing Act). Participant has transferred and delivered to Trustee the sum of _____ Dollars ($_____) in cash, as an initial contribution to the trust account hereby established.

NOW, THEREFORE, IT IS AGREED by and between Participant and Trustee that each party will abide by the laws and rules applicable to Individual Housing Accounts and that contributions made to the trust will be held and distributed pursuant to the terms of this Agreement as follows:

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ARTICLE I. REPRESENTATIONS

1.1 Trustee is a financial institution authorized by law to act as Trustee for Individual Housing Accounts.

1.2 Trustee actively makes residential real estate mortage loans in Minnesota.

1.3 Participant does not now own and has never owned a principal residence wherever located.

1.4 Participant does not now have another IHA either with this institution or any other institution.

ARTICLE II. REVOCATION

2.1 Unless Trustee has furnished a disclosure statement to Participant at least seven days prior to the date of this Agreement, the Trust shall not take effect until seven days after the date of this Agreement.

2.2 During the seven day period provided in paragraph 2.1, Participant may revoke this Agreement and receive back any deposits made to Trustee. The Agreement shall not constitute an Individual Housing Account. The Trustee will not withhold tax upon the revocation.

2.3 If during the period provided in paragraph 2.1, Participant does not revoke the Agreement, the trust shall relate back in time to the date of this Agreement.

ARTICLE III. CONTRIBUTIONS

3.1 Trustee will accept additional deposits which shall become part of the corpus of this trust.

3.2 Participant will contribute and Trustee will accept no more than $2,500 of total deposits to the trust in any taxable year and no more than $10,000 of total deposits to the trust for all taxable years.

3.3 All deposits will be made in cash.

ARTICLE IV. INVESTMENTS

4.1 The assets of the trust will be invested only in savings or time deposits in amounts fully insured by a Minnesota agency or a federal agency established for the purpose of insuring accounts in financial institutions.

4.2 The assets of the trust may be commingled for purposes of investment provided that individual records are maintained by Trustee for Participant, as prescribed by the Commissioner of Revenue.

ARTICLE V. WITHDRAWALS

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Repealed 83R1079 11-7-73

5.1 Participant may withdraw amounts from the trust at any time by written notice to the Trustee.

5.2 Trustee shall deduct and withhold from any amount withdrawn a tax in the amount of 10 percent of the amount withdrawn unless Trustee receives from Participant a written verification statement pursuant to paragraphs 5.3 or 5.4.

5.3 Trustee will not deduct and withhold tax from any amount withdrawn if he receives from Participant a written statement, in accordance with rules of the Commissioner of Revenue, verifying that the amount withdrawn is being used for the purchase of Participant's first principal residence and the residence is located in Minnesota. In this case Trustee will make the amount withdrawn payable to the seller, or the seller's designee (other than the buyer/Participant).

5.4 Trustee will not deduct and withhold tax from any amount withdrawn if he receives a written statement verifying, in accoredance with rules of the Commissioner of Revenue, that Participant has died or has become disabled.

5.5 Trustee will remit and pay the tax deducted and withheld under paragraph 5.2 to the Commissioner of Revenue as required by law.

ARTICLE VI. TERMINATION

6.1 This trust will terminate no later than 10 years after the date of this agreement.

6.2 Upon termination, Trustee will deduct and withhold from the trust corpus a tax in the amount of 10 percent of the corpus and remit and pay the tax to the Commissioner of Revenue, as required by law.

6.3 Upon termination, Trustee will distribute the corpus of the trust to Participant, less the taxes deducted and withheld under the preceding paragraph, in accordance with rules of the Commissioner of Revenue.

6.4 The trust shall terminate upon the death of Participant, or the survivor of the Participants, in which case Trustee will pay over the entire corpus of the trust and earnings thereon to the decedent's estate. No taxes will be withheld.

ARTICLE VII. RECORDS AND REPORTS

7.1 Trustee will keep records and accounts of its administration of the trust.

7.2 Trustee will provide reports to Participant and to the Commissioner of Revenue at the times and in the manner prescribed by the Commissioner of Revenue.

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7.3 Participant will furnish to Trustee the information prescribed by the Commissioner of Revenue.

ARTICLE VIII. OTHER PROVISIONS

(Other provisions that do not conflict with any laws, rules or other provisions of this trust agreement may be added here.)

IN WITNESS WHEREOF, the parties hereto set their hand the day and year first written above.

_____
Participant

_____
Participant

_____
Trustee

By _____
Its _____

DISCLOSURE STATEMENT FOR

INDIVIDUAL HOUSING ACCOUNTS

NOTICE: YOU MAY REVOKE this account by contacting the following person within seven days from the date of your trust agreement. (See Part VIII of this statement for explanation.)

Name: _____

Address: _____

Telephone Number: _____

I. INTRODUCTION.

The Individual Housing Account (IHA) is designed to help a first-time home buyer save up money for the purchase of his or her home by not taxing as income the first $1,500 that you contribute to an IHA each taxable year, and by not taxing the interest earned on the account, with certain limitations that are explained in this statement.

BEWARE, however, that there will be a substantial tax penalty due if you use any of the money from this account for any other purpose than your first home. In fact, the trustee must withhold and send to the Department of Revenue 10 percent of any withdrawal that you make if you are not going to use the amount for the purchase of your first residence.

II. ELIGIBILITY.

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Repealed 85R1079 11-7-83

To be eligible to set up an IHA, you or your spouse must not now own and never have owned your own principal residence.

Furthermore, you or your spouse must not now have another IHA, whether at this institution or any other financial institution.

III. TAX DEDUCTION AND LIMITS THEREON

Amounts that you deposit in your IHA may be deducted for Minnesota income tax purposes for the tax year in which you make the deposit. However, to be deductible, the amount must have been on deposit in the account for at least six months during the tax year. And your deduction for deposits to the account cannot exceed $1,500 for any one tax year and your total deductions for deposits for all tax years cannot exceed $10,000.

In addition to the deduction for the amounts that you deposit in your IHA, you are allowed an income tax deduction for the interest earned on your IHA during the tax year. This deduction for interest, however, is limited to interest on deposits of $2,500 or less per year or on total deposits of $10,000 or less for all taxable years. Interest cannot be deducted on amounts in excess of these limits.

IV. PENALTY TAX FOR NOT USING IHA FOR FIRST RESIDENCE

Your IHA is supposed to be used to purchase your first principal residence. The residence must be located in Minnesota. If you withdraw money from your IHA and do not use it for the purchase of your first principal residence, which is located in Minnesota, there is a substantial tax penalty due. Not only will you have to include the amount you withdraw in your income for Minnesota tax purposes and pay income tax on it, but you will also have to pay an additional tax of 10 percent of the amount withdrawn. The additional 10 percent tax will not, however, be due if the withdrawal was made because of your disability or death.

Your IHA can last only 10 years. Therefore, you must use the IHA to purchase your first residence within 10 years after the IHA is opened. If you do not use the IHA within 10 years, the IHA automatically terminates and the taxes and penalties explained in the preceding paragraph are applicable just as if you had made a withdrawal of all of the money in the account.

You are not allowed to use or pledge your IHA as security for a loan. If you do so, the amount so pledged will be treated as a withdrawal. You will have to include the amount pledged in your Minnesota taxable income and pay the 10 percent additional tax, just as if you had made a withdrawal of that amount and not used it for your first principal residence.

V. TRUSTEE MUST WITHHOLD TAX ON CERTAIN WITHDRAWALS

If you make a withdrawal from your IHA which will not be

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used to purchase your first principal residence or the residence you do purchase is not located in Minnesota, the trustee must withhold as tax 10 percent of the amount of your withdrawal. The trustee must send the amount withheld to the Department of Revenue to be applied against your additional tax liability. If the withdrawal is due to your death or disability, however, the trustee is not required to withold this tax.

The trustee also must withhold the 10 percent tax whenever the IHA terminates because the account was not used for your first residence within 10 years from the date that you established the account.

VI. LIMITATIONS ON THE AMOUNT THAT YOU MAY DEPOSIT IN THE IHA

You are permitted to deposit no more than $2,500 to your IHA in any one tax year. Moreover, you are permitted to deposit no more than a total of $10,000 to your IHA for all taxable years. If you deposit more than you are allowed, you must pay an additional tax of six percent of the amount which exceeds these limits. This six percent additional tax is in addition to your regular income tax liability and is due for every year in which the excess deposit remains in your account.

VII. TRANSFERS OF YOUR ACCOUNT TO A DIFFERENT FINANCIAL INSTITUTION

You may transfer your IHA to another financial institution. If you follow the rules explained in this paragraph, your transfer of funds will not be treated as a withdrawal and not subject to tax or penalty. To transfer the IHA tax free, you must:

(1) Have the entire amount in the account made payable to the new trustee or financial institution.

(2) Transfer the entire account to a different financial institution and close out the original account. You cannot have more than one IHA at a time.

(3) Have the new IHA terminate 10 years from the date that you opened the original IHA. To do this you must inform the new trustee of the date on which you opened your original IHA and have him put the proper termination date in the new trust agreement.

VIII. REVOCATION OF YOUR IHA

You must be given seven days to read this statement and consider your decision to participate in the IHA program. Your IHA does not become final until this seven day period is over. During the seven day period, you may revoke your IHA and receive your money back without it being treated as a "withdrawal." Therefore, the regular taxes and additional taxes for failure to use the account for the purchase of your first principal

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Repealed 85R1079 11-7-83

residence, as explained in Part IV of this disclosure statement, will not be due. After this seven day period, however, any withdrawal that you make and do not use for your first residence, will be subject to both regular tax and additional tax, as explained in Part IV.

The name of the person to contact if you wish to revoke this account is listed at the beginning of this disclosure statement.

IX. AUTHORITY AND QUALIFICATIONS OF TRUSTEE

This financial institution is authorized by law to act as the trustee of your IHA. The trustee has either been approved by the Minnesota commissioner of banks to act as the trustee of IHAs or under federal law is not required to obtain this approval.

Your IHA meets all of the requirements of Minnesota Statutes, section 290.09, subdivision 30 and any applicable rules issued by the Minnesota commissioner of revenue. Furthermore, the trustee agrees to abide by all laws and rules applicable to IHAs.

X. YOUR RESPONSIBILITIES

You, as the participant of this IHA, have certain duties and responsibilities imposed on you. You must be sure that the financial institution is qualified to act as the trustee of your IHA. Also, you must be sure that the trustee will abide by any laws or rules applicable to IHAs. Finally, you must be sure that your IHA is set up according to the law and rules.

If at some future time it is discovered that your trustee is not qualified or is not abiding by the laws or rules or your IHA does not meet all the requirements of the laws and rules, you will not be allowed a tax deduction for the years involved.

Finally, there are certain forms you must file and information you must furnish to either the trustee or the Minnesota Department of Revenue. As mentioned in Part V of this disclosure statement, the trustee must withhold as tax ten percent of any withdrawal that you make unless you are using the amount withdrawn for your first principal residence. In order to avoid this withholding of tax, you must furnish to the trustee a written statement, verifying that you are using the withdrawal for your first principal residence and that the residence is located in Minnesota. In this case, the trustee must make the withdrawal payable to the seller. The trustee cannot make the withdrawal payable to you alone. The withholding of tax may also be avoided if you die or become disabled by furnishing the trustee with verification form certifying that you have died or become disabled. If you fail to furnish completed and signed verification forms to the trustee, the trustee is required by law to withhold the 10 percent tax.

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To claim the income tax deduction on your Minnesota income tax return, you must attach a copy of the statement or statements of account that you receive from the trustee which show the date and amount of your deposits to the IHA and the date and amounts of any withdrawals during the entire tax year.

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13 MCAR § 1.6020 Energy credit. *(Effective 3/25/80, amendments effective 6/30/81)*

A. General provisions.

1. Residence. For purposes of this credit, a building or dwelling unit must be the taxpayer's principal residence. The term "principal residence" is defined as that residence which would qualify for the nonrecognition of gain on the sale and the rollover of that gain when a new principal residence is purchased except that no ownership requirement is imposed. The period for which a building or a dwelling unit is treated as the principal residence of the taxpayer includes the 30 day period ending on the first day on which it would (but for this sentence) be treated as the taxpayer's principal residence. The term "building" includes a single family dwelling, duplex, condominium unit, townhouse, cooperative unit, and any other residential building containing six dwelling units or less. A condominium unit, a townhouse, or a cooperative unit which is used by a taxpayer as his principal residence will each qualify separately for purposes of this credit regardless of how many units are in the building. A taxpayer who buys or rents a residential unit in a condominium, townhouse or a cooperative need only buy or rent that unit and not the entire physical structure to qualify for this credit.

Individuals who rent a dwelling unit as their residence can claim this credit. The dwelling unit, except in the case of the rental of a condominium, townhouse, or cooperative unit, must be located in a building that contains six dwelling units or less.

If less than 80 percent of the use of a building or dwelling unit is for use as the taxpayer's principal residence, only that portion of the expenditures for that building or dwelling unit which is properly allocable for use as the taxpayer's principal residence shall be taken into account. A swimming pool shall be treated as a use which is not for residential purposes. These provisions on residence do not apply to biomass conversion equipment.

2. A taxpayer must actually purchase the equipment or earth sheltered dwelling to qualify for this credit. The expenses connected with the leasing of equipment or the leasing of an earth sheltered dwelling do not qualify for this credit. If the taxpayer received a refund from the seller or the manufacturer of equipment on which the taxpayer claimed this credit, the amount of expenditures that were allowable for this credit must be reduced by the amount of the refund that was received. The taxpayer will need to file an amended income tax return if the refund that was received would require a reduction in the energy credit which had already been claimed. A payment received by the taxpayer from the seller or the manufacturer of equipment is considered as a payment for services rendered when the payment was for field testing of the system by the taxpayer or for reports on the system that the taxpayer completed. A payment for services rendered must be included in the gross income of the taxpayer and does not reduce the amount of expenditures allowable for this credit. Expenditures will qualify even though they are paid for as the result of a federal, state, or local government grant, but only to the

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extent that the grant was included in federal adjusted gross income. Each dollar of expenditure which qualifies for this credit may be used only one time for purposes of computing this credit.

3. A contractor can receive this credit on a building that he has constructed if he is the first individual to use the building or dwelling unit as his principal residence.

4. For purposes of this credit, a taxpayer is entitled to use only the first $10,000 of renewable energy source expenditures. The $10,000 of expenditures to which the taxpayer is entitled includes the expenditures that he personally made, and the proportionate share of expenditures to which he is entitled as a partner in a partnership, as a shareholder in a Subchapter S corporation, as a tenant shareholder in a cooperative housing corporation, as a member of a condominium management association, or as a shareholder in a family farm corporation. No taxpayer shall be allowed to claim a total amount of more than $2,000 in total energy credits for all years.

5. The increase in the basis of property because of expenditures which qualify for this credit shall be reduced by the amount of the energy credit that was claimed for that property.

6. A shareholder in a family farm corporation is allowed to claim this credit for any of the expenditures that qualify for this credit. A family farm partnership will be treated as an individual taxpayer and expenditures that qualify for the energy credit which are made by the family farm partnership, may be claimed by the family farm partners as joint owners. A partnership, which is not a family farm partnership, will not be treated as an individual taxpayer.

7. A shareholder of a family farm corporation is allowed to claim this credit in the same manner as a joint owner of property that otherwise qualified for the credit. All joint owners will be treated as one taxpayer (and so qualify for only one $2,000 energy credit) with the same taxable year. Each joint owner will be allowed, with respect to the expenditures, a credit for that taxable year in an amount, which bears the same ratio to the total amount allowable, as the amount of the expenditures made by the joint owner during the taxable year bears to the aggregate of the expenditures made by all joint owners during the taxable year. However, joint owners who make expenditures with respect to two or more principal residences shall compute the amount of their energy credit separately based on the amount of the expenditure made by each joint owner. If a Subchapter S or a family farm corporation makes the expenditure, the expenditure may be divided among the shareholders based on the percentage of their stock ownership in the corporation.

8. The Department of Revenue, upon the written request of a taxpayer, shall furnish the Energy Agency with a copy of the energy credit form that has been completed by the taxpayer so that the taxpayer and the Department of Revenue may receive technical advice and assistance from the Energy Agency and so that the Energy Agency may compile information on the use of this credit.

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9. The energy credit, pollution control credit and feedlot pollution control credit shall be applied after all other nonrefundable credits. If the expenditures otherwise qualify, the taxpayer may elect which credit (including the carryforward) will be used. This election may be amended at any time before the expiration of the statute of limitations. If an expenditure otherwise qualifies the taxpayer may claim both the energy credit and the feedlot pollution control credit or pollution control credit on that property but the energy credit must be used first and the expenditures allowable for the feedlot pollution control credit or pollution control credit must be reduced by the expenditures that have been used for the energy credit. The taxpayer may elect to carryforward the amount of the energy credit, pollution control credit and feedlot pollution credit when the taxpayer's tax liability is computed by using the low income alternative tax.

10. As used in this rule, the term "R" value is the measure of resistance to heat flow through a material or the reciprocal of the heat flow through a material expressed in British thermal units per hour per square foot per degree Fahrenheit at 75 degrees Fahrenheit mean temperature. The term "U" value is the thermal transmission of heat in unit time through unit area of a particular body or assembly, including its boundary films divided by the difference between the environment temperatures on either side of the body or assembly; $(Btu/Hr \cdot Ft^2 \cdot F^o)$. Also the reciprocal of total R-Value.

B. Piggybacked federal renewable energy source credit. Any expenditure that qualifies for the federal renewable energy source credit, including expenditure for labor costs, geothermal energy, wind energy for electricity, renewable energy used to heat water, and any other expenditures which are allowable for the federal credit, would also be allowable for purposes of the state piggybacked credit provided that the building is located in Minnesota and does not contain more than six dwelling units. After December 31, 1980, any active solar collector which qualifies for the federal renewable energy source credit must also be certified by the Minnesota Energy Agency before it will qualify for the state piggybacked federal renewable energy source credit. Expenditures that are allowable are only those that were allowable on the date that the legislature has specified in Minn. Stat. § 290.06, subd. 14 for purposes of adopting the federal credit provisions. No solar panel installed as a roof (or portion thereof) shall fail to qualify for the piggybacked federal renewable energy source credit solely because it constitutes a structural component of the dwelling on which it is installed. If an expenditure qualifies for both the federal energy conservation credit and for the federal renewable energy source credit and the taxpayer used the expenditure for the federal conservation credit, the taxpayer can use that expenditure for the state piggybacked federal renewable energy source credit provided that the expenditure otherwise qualifies.

C. Earth sheltered dwelling units. Expenditures that qualify for the credit for earth sheltered dwellings include material, labor and other construction costs (except interest) incurred to construct the dwelling. The structure of the earth sheltered dwelling unit must meet the standards of the Minnesota building code even though the code may not be in effect in that area. The

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earth sheltered dwelling unit's structure must also comply with all three tests which are contained in Minn. Stat. § 290.06, subd. 14(b)(1)-(3) and which are as follows:

" (1) 80 percent or more of the roof area is covered with a minimum depth of 12 inches of earth; and

(2) 50 percent or more of the wall area is covered with a minimum depth of 12 inches of earth; and

(3) Those portions of the structure not insulated with a minimum of seven feet of earth shall have additional insulation;"

The roof area contained in Minn. Stat. § 290.06, subd. 14(b)(1) that must be covered with earth means that area of the roof that is above the area used for residential living which is heated. The roof area that must be covered with earth does not include the roof area for a garage, unless the garage is heated. For § 290.06, subd. 14(b)(2) the term "wall" means the exterior walls of the residential living area. The walls of a garage are not included in this definition. If a garage is attached to the exterior walls at the residential living area, that area of the exterior wall of the residential living area that is part of the attached garage is not counted in the area of the wall that must be covered with earth. The wall must be covered with a minimum horizontal depth of 12 inches (30 cm) of earth. The term "structure" contained in § 290.06, subd. 14(b)(3) means the exterior walls and roof as defined for § 290.06, subd. 14(b)(1) and (2). In § 290.06, subd. 14(b)(3) the additional insulation that will be required is the amount of insulation that is needed to equal the following requirements:

1. All of the components of the wall below grade to 7 vertical feet (2.1 m) below grade must have at least a combined minimum R value of 11.50 $F^{o} \cdot Hr \cdot Ft^{2}/Btu$ (2.03 $m^{2} \cdot K/W$), not including the thermal resistance of the earth. Insulation below grade which extends out from the wall may be included in the combined R value.

2. The wall which is above grade and which is not covered with a minimum of 7 horizontal feet (2.1 m) of earth and which is not part of a collection aperture of a passive solar system, as defined in E. 2., must meet the following criteria:

a. The opaque wall area may not exceed a maximum U value of 0.0555 $Btu/Hr \cdot Ft^{2}F^{o}$ (0.315 $W/m^{2}K$).

b. The glazing area must not exceed a maximum U value of 0.47 $Btu/Hr \cdot Ft^{2} \cdot F^{o}$ (2.7 $W/m^{2}K$) and must not exceed a maximum area which is more than 10% of the floor area of the room in which it is installed. The maximum glazing area for a room shall be reduced by the amount of collection aperture glazing, as defined in E.2., installed in that room. Glass doors shall be considered as glazing area.

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c. The doors must not exceed a maximum U value of 0.40 Btu/Hr·Ft^2·F^o (2.3 W/m^2·K).

3. Roof/ceiling.

a. A roof/ceiling which is covered with less than 7 vertical feet (2.1 m) but with 12 vertical inches (30 cm) or more of earth may not exceed a maximum U value of 0.045 Btu/Hr·Ft^2·F^o (0.25 W/m^2·K), not including the thermal resistance of the earth.

b. A roof/ceiling which is covered with less than 12 vertical inches (30 cm) of earth may not exceed a maximum U value of 0.027 Btu/Hr·Ft^2·F^o (0.15 W/m^2·K), not including the thermal resistance of the earth.

D. Biomass conversion equipment. The term "biomass conversion equipment" means equipment which is located in Minnesota and which is (1) equipment for the production of gaseous fuels from biomass sources by biological or physical-chemical processes. To qualify for the credit, the gaseous energy produced shall sustain combustion, by itself, in air. Examples of the types of equipment that qualify for the credit are methane digestors, and destructive distillation equipment. (2) Equipment for the production of liquid fuels from biomass sources by biological or physical-chemical processes. To qualify for the credit, the liquid fuel produced shall sustain combustion, by itself, in air, and shall contain ethanol or methanol.

The gaseous energy or liquid fuels produced by the equipment shall not be sold or offered for sale.

The term "biomass sources" means wood, wood residues, agricultural crops, agricultural crop residues, other plant materials, human or animal manure, and food processing waste.

A taxpayer who is a corporation (including an electing small business corporation), a partnership, a trust or an estate may claim the credit for biomass conversion equipment.

E. Passive solar energy system.

1. General. The term "passive solar energy system" means a system which utilizes the building or an attached building (such as a greenhouse) and its operable components to heat and cool the building or a portion thereof by utilizing the sun's energy by means of conduction, convection, radiation or evaporation.

A system shall include collection aperture and storage element designed to store heat from solar radiation, and it may include control, distribution or retention elements.

Only the cost of equipment, materials, and devices which are integral parts of a passive solar energy system and the actual cost of labor for system in-

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stallation are eligible expenditures. Expenditures for equipment, materials, or devices which are a part of the conventional (nonrenewable energy) heating, cooling, or insulation system of the building are not eligible for the credit. The entire expenditure for each integral component and associated labor costs is eligible for the credit unless indicated below.

To qualify for the credit, a passive solar energy system must reasonably be expected to remain in operation for at least five years.

2. Collection aperture. The term "collection aperture" means a. Double glazing material facing south, plus or minus 30 degrees, installed in exterior walls, and fully exposed to the sun for at least four hours on December 21, during which time the sun must pass through an imaginary vertical plane drawn perpendicular to the glazing. The area of glazing shall exceed the lesser of 15 percent of the floor area of the room in which the glazing is installed or 8 percent of the floor area of the habitable rooms within the dwelling unit. The entire expenditure for glazing shall qualify for the credit. b. Double glazing material installed in a roof which is elevated at an angle of at least 45 degrees from horizontal and which faces the south, plus or minus 30 degrees. Such glazing shall be fully exposed to direct solar radiation for at least four hours on December 21. A taxpayer who has installed both a wall and a roof collection aperture may qualify.

3. Storage element. The term "storage element" means thermal mass in the form of water, masonry, brick, rock, concrete or other material with heat storage performance equivalent to or better than that of any of these forms of thermal mass. The thermal mass must be installed within the insulated shell of the building or attached building and it must be insulated from the earth by materials with at least an R value of 6.5 $F^{o} \cdot Hr \cdot Ft^{2}/Btu$ (1.1 $m^{2} \cdot K/W$). The thermal mass must have a storage capacity of at least 15 Btu per degree Fahrenheit per square foot (300 $kJ/K \cdot m^{2}$) of aperture area. The thermal mass shall be situated so that at least half of it is completely exposed to the sun's direct radiation for four hours on December 21. The exposed half of the thermal mass must not be shielded from direct solar radiation by hangings, rugs, carpet, furniture, etc. Thermal mass which is heated by forced convection can also qualify. An example would be that of a system in which a blower forces solar air from a collection area through a rock bed, when the rock bed has been insulated to prevent heat loss into the earth or outside air.

The entire amount of the expenditures and labor costs allocable to qualifying thermal mass will be allowed. Concrete slab floors uninsulated from the earth and swimming pools do not qualify as a storage element for purposes of this credit. Stone and masonry materials used in fireplace construction, which meet the above requirements for thermal mass, will qualify as a storage element. The flues and other mechanical devices of a fireplace do not qualify.

4. Control and distribution element. The term "control and distribution element" means fans, exhausts, vents, dampers, sensors, controllers, air ducts, louvers or other equipment when used exclusively to facilitate the distribution of solar heat.

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5. Retention element. The term "retention element" means movable insulation which is installed to reduce heat loss through the collection aperture of the passive solar energy system at night. All of the movable insulation installed on that collection aperture must have a combined R value of at least 4 $F^{o} \cdot Hr \cdot Ft^{2}/Btu$ (0.7 $m^{2}K/W$). Awnings and overhangs shall not be considered retention elements.

6. Miscellaneous. The Commissioner of Revenue will require drawings, photographs, or other descriptions of a passive solar energy system from any taxpayer claiming the credit for a passive solar energy system. The commissioner may consult with the Director of the Minnesota Energy Agency to secure an evaluation of the drawings, photographs, or other descriptions to determine if the system qualifies for the energy credit.

A taxpayer who has installed or is planning to install a passive solar energy system which he or she feels may achieve passive solar energy performance better than a system designed according to the criteria contained in this rule may request an advisory opinion by submitting an architectural drawing, a detailed operational description of the system and performance calculation to the Director of the Energy Agency. On the basis of this information, the director may decide that the entire system and its integral components or some part thereof qualifies for the credit. The taxpayer shall furnish the Department of Revenue with a copy of the Director's Opinion when claiming this credit.

The original use of the passive solar energy system must begin with the taxpayer who claims the credit. Expenses for normal maintenance on the passive solar energy system do not qualify for the credit. Replacement expenditures of a capital nature to replace all or part of the passive solar energy system do qualify for the energy credit provided that the taxpayer must add these expenditures to the other expenditures that he had already claimed for the energy credit. Those passive solar energy system expenditures which exceed a reasonable cost amount, which serve no additional passive solar function, or which serve a purely aesthetic function, shall not be allowed.

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13 MCAR § 1.6030 Nongame wildlife checkoff. *(Effective date 6/30/81)*

A. Charitable contribution. A designation by a taxpayer to the Nongame Wildlife Management Fund qualifies as a charitable contribution under the provisions of Minn. Stat. § 290.21, subd. 3 in the year in which the designation was made.

B. Administration.

1. A taxpayer may reverse all or part of the designation that was made to the Nongame Wildlife Management Fund where the designation was originally made in error and the taxpayer had no intention to make a gift when the designation was made. A taxpayer may not reverse the designation to the Nongame Wildlife Management Fund merely because the taxpayer, at a later date, changes the intention to make a gift to the fund. It will be presumed that the taxpayer intended to make a designation when more than 90 days have elapsed since the taxpayer received the refund check or a notice informing the taxpayer that a designation was made to the Nongame Wildlife Management Fund with the following two exceptions:

a. The taxpayer has a valid explanation showing why no action was taken within the 90 day period. Examples of a valid reason are sickness or being outside of the country.

b. The taxpayer considered the designation to the Nongame Wildlife Management Fund as a payment of estimated income tax and properly accounted for this amount as an estimated tax payment on the taxpayer's income tax return for the following year.

A taxpayer may designate that all or part of his refund on an amended return go to the Nongame Wildlife Management Fund.

2. An individual, fiduciary, trust or estate may designate all or part of their refund to the Nongame Wildlife Management Fund. A corporation or a partnership may not make this designation.

3. Taxpayers who are allowed to claim the property tax refund as a credit on their income tax return may make a designation to the Nongame Wildlife Management Fund only on their income tax return.

4. The amount of the refund from which a taxpayer may make a designation to the Nongame Wildlife Management Fund is determined after the following deductions have been made:

a. Unpaid Minnesota tax liabilities owed to the Commissioner of Revenue.

b. A debt which qualifies for the provisions of the Revenue Recapture Act contained in Minnesota Statutes Chapter 270A.

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c. Amounts credited to the estimated income tax liability for taxable year.

5. Machine audit.

a. The term "machine audit" means the adjustments made to a taxpayer's return in the original processing of the return from the date the return is filed until the date the refund is granted or the order assessing additional tax is issued.

b. If, upon machine audit, a taxpayer's overpayment is reduced, the reduction shall be made in the following order:

(1) The amount of the overpayment that the taxpayer had requested as a refund is reduced.

(2) The amount of the overpayment that the taxpayer had designated to the Nongame Wildlife Management Fund is reduced.

c. If, upon machine audit, the taxpayer no longer has an overpayment but is assessed a tax balance due, the designation to the Nongame Wildlife Management Fund is cancelled.

6. A taxpayer, who owes a tax balance due (including penalty and interest) on his income tax return, may designate that an amount be paid to the Nongame Wildlife Management Fund by paying the entire balance that is due for both the tax liability and the designation to Nongame Wildlife at the same time that the return is filed. If the amount that is paid with the return does not equal the tax balance due and the amount designated to Nongame Wildlife, the amount of the tax balance due shall be paid first. If the amount that is paid with the return does not fully pay the tax balance due, the designation to the Nongame Wildlife Management Fund shall be cancelled.

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13 MCAR § 1.6101 Practice of attorneys, accountants, agents, and preparers before the Department of Revenue. *(effective date 2/17/82)*

A. Practice defined. The term "practice" comprehends all matters connected with the presentation by an attorney, accountant, agent, or preparer to the Department of Revenue or any of its employees, upon filing an executed power of attorney, of a client's rights, privileges, or liabilities under Minn. Stat. ch. 290 or 290A, and the rules thereunder. Practice includes the preparation and filing of necessary documents, correspondence with and communication to the Department of Revenue, and the representation of a client at conferences, hearings, and meetings. However, the preparation and signing of a tax return, the appearance of an individual as a witness for a taxpayer, and the furnishing of information at the request of the Department of Revenue or any of its employees do not, of and by themselves, constitute practice before the department, unless these acts are coupled with the presentation of a client's case at conferences, hearings, or meetings. For purposes of this rule, the term "practice" is synonymous with "representation."

B. Scope of representation pursuant to power of attorney.

1. When authorized by the taxpayer through a written power of attorney, an attorney, accountant, agent, or preparer may appear as the taxpayer's representative, with or without the taxpayer, before an employee of the Department of Revenue with respect to the tax liability of the taxpayer for the type of tax and taxable year or period authorized in the power of attorney.

2. For purposes of this rule, a power of attorney grants authority to deal with any of the following: original or amended individual income tax returns; property tax refund returns; fiduciary income tax returns; partnership returns of income; corporation income tax returns, including returns of small business corporations, life insurance companies, banks, and savings and loan associations; employer's income tax withholding returns or deposits; claims for refund; and estimated tax declarations.

3. A taxpayer representative may inspect only those state records, files, or documents which are either specifically listed, or directly or indirectly connected with matters specifically listed, in a power of attorney.

4. If the taxpayer is not present, a person presenting a power of attorney shall present identification satisfactory to the department employee.

C. Persons ineligible to practice. Any person who is:

1. Under disbarment or suspension from practice before the Department of Revenue;

2. An employee of the Department of Revenue;

3. Under disbarment or suspension from practice as an attorney, certi-

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fied public accountant, or licensed public accountant in the State of Minnesota; or

4. Under disbarment or suspension from practice before the Internal Revenue Service shall be ineligible to appear as a taxpayer representative under this rule. However, with regard to 3. and 4., a granting of reinstatement to practice as an attorney, certified public accountant, or licensed public accountant, or a granting of reinstatement to practice before the Internal Revenue Service shall automatically reinstate a person's eligibility to practice before the Department of Revenue.

D. Standards of ethics and conduct.

1. No attorney, accountant, agent, or preparer acting as a taxpayer representative shall neglect or refuse to submit records or information in any matter before the Department of Revenue, upon proper and lawful request by a duly authorized employee of the Department of Revenue, unless the taxpayer representative has a good faith belief that the information or testimony is privileged. No taxpayer representative shall interfere, or attempt to interfere, with any proper and lawful efforts by the Department of Revenue or its employees to obtain information relative to any matter before the Department of Revenue. Insisting upon a subpoena shall not be a violation of this paragraph.

2. Each taxpayer representative shall exercise due diligence in regard to all of the following:

a. Preparing, assisting in the preparation of, approving, and filing returns, documents, affidavits, and any other papers relating to Department of Revenue matters to the extent of participation;

b. Determining the correctness of representations made by him to the Department of Revenue; and

c. Determining the correctness of representations made by him to clients with reference to any matter administered by the Department of Revenue.

3. Each taxpayer representative shall exercise good faith in determining the correctness of representations made by clients to him with reference to any matter administered by the Department of Revenue when the preparer or agent has reasonable grounds to believe the client's representations are false or inaccurate.

4. No taxpayer representative shall unreasonably delay the prompt disposition of any matter before the Department of Revenue.

5. Where there is a conflict between this rule and a code of conduct which is promulgated by another agency or branch of government, that code of conduct shall control. The taxpayer representative must disclose to the department that there is a conflict.

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E. Incompetent conduct. Incompetent conduct, for which any attorney, accountant, agent, or preparer shall be subject to disbarment or suspension from practice before the Department of Revenue, means the failure by an attorney, accountant, agent, or preparer, after due warning has been given by the Commissioner of Revenue pursuant to G.3., to:

1. Demonstrate the familiarity with the income tax statutes, rules, and forms necessary to enable the practitioner to properly apply, discuss, or complete them, and thus to render adequate services in connection with a taxpayer's case before the Department of Revenue; or

2. Exercise due diligence as required in D.2. The standard used for determining failure to exercise due diligence shall be the common law standard of reasonableness used in determining negligence.

F. Disreputable conduct. Disreputable conduct, for which any attorney, accountant, agent, or preparer shall be subject to disbarment or suspension from practice before the Department of Revenue, includes any conduct violative of D. In addition, the following acts or events constitute disreputable conduct:

1. Conviction of any criminal offense under a state or federal tax statute, or conviction of any crime involving dishonesty or breach of trust;

2. Preparing or filing for oneself or another a false or fraudulent Minnesota income tax return or other statement on which Minnesota income taxes or a refund thereof may be based, knowing it is false or fraudulent;

3. Willful failure to prepare or file a Minnesota income tax return for oneself or another in violation of the applicable income tax statutes or rules;

4. Willful failure to prepare and file an amended Minnesota income tax return for oneself, knowing that a material error or omission was made on the original return;

5. Willful failure to recommend to a client that an amended Minnesota income tax return be prepared and filed, knowing that a material error or omission was made on the original return;

6. Advising a client or a prospective client to adopt a Minnesota income tax evasion plan which is not legal, knowing that the plan is not legal;

7. Giving false testimony or information in any proceeding before the Department of Revenue, or before any tribunal authorized to pass upon Minnesota income tax matters, knowing it is false;

8. Filing any false or fraudulently altered document, affidavit, or power of attorney in any case or other proceeding before the Department of Revenue, or procuring the filing thereof, knowing it is false or fraudulently altered;

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9. Using, with intent to deceive, false representations to procure employment in any case or proceeding before the Department of Revenue, including, but not limited to:

a. Misrepresentations regarding eligibility to practice before the Department of Revenue;

b. Specific material misrepresentations regarding experience or education, whether general or specialized, as an income tax return preparer;

c. Guaranteeing the payment of any tax refund or the allowance of any tax credit; or

d. Representing to a client that the attorney, accountant, agent, or preparer can improperly obtain special consideration or action from the Department of Revenue or an employee thereof, or that he has improper access to sources of information within the Department of Revenue which are otherwise private, confidential, or nonpublic;

10. Approving for filing, or advising or aiding in the preparation of, a false or fraudulent Minnesota income tax return prepared by some other person, knowing the return is false or fraudulent;

11. Misappropriation of, or failure to properly and promptly remit, funds received from a client for the purpose of paying taxes or other obligations due the State of Minnesota;

12. Endorsement or negotiation of a client's check in payment of a refund of any tax, credit, penalty, or interest administered by the Commissioner of Revenue, without the client's prior endorsement. The preceding sentence shall not apply when the full amount of the check is deposited in the taxpayer's bank account for the benefit of the taxpayer;

13. Charging a client a fee based upon a percentage of the refund that the client is eligible to receive from the State of Minnesota, unless representation of the client reaches the contested stage, either in a formal administrative hearing or a court proceeding;

14. Attempting to influence, or offering or agreeing to attempt to influence, the official action of any employee of the Department of Revenue by the use of threats, false accusations, duress, or coercion, by the offer of any special inducement or promise of advantage, or by the bestowing of any gift, favor, or thing of value;

15. In connection with practice before the Department of Revenue, making false accusations or statements knowing them to be false, or circulating or publishing slanderous or libelous matter concerning the Department of Revenue or any of its employees;

16. Knowingly aiding and abetting another person to practice before the

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Department of Revenue during a period of disbarment or suspension of the other person;

17. For purposes of 1. through 16., the phrases "income tax" and "income tax return" include all matters referred to in B.2.

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G. Disbarment and suspension procedures.

1. Authority to disbar or suspend. Pursuant to Minn. Stat. § 290.52, the Commissioner of Revenue, after due notice and opportunity for hearing, may suspend or disbar from further practice before the Department of Revenue any attorney, accountant, agent, or preparer who: is shown to be incompetent or disreputable; refuses to comply with the provisions of this rule; or in any manner willfully and knowingly defrauds, deceives, or misleads any taxpayer with respect to a claim or prospective claim involving the Department of Revenue.

2. Violation of rule. Any attorney, accountant, agent, or preparer shall be subject to disbarment or suspension from practice before the Department of Revenue for violation of any of the provisions contained in this rule.

3. Notification of violation of rule and issuance of warning. Whenever the Commissioner of Revenue has sufficient grounds to believe that any attorney, accountant, agent, or preparer has violated a provision of this rule, he shall notify the practitioner in writing of the specific violation which has been committed. The notification shall contain a warning to the practitioner that if the violation continues, or if any other violations are committed, the commissioner shall commence a proceeding for disbarment or suspension of the practitioner.

4. Commencement of disciplinary proceeding. Whenever the Commissioner of Revenue has sufficient grounds to believe that any attorney, accountant, agent, or preparer has failed to comply with a warning by continuing to violate any provision of this rule, he shall commence a proceeding for disbarment or suspension of the attorney, accountant, agent, or preparer. The commissioner's Notice of and Order for Hearing shall set forth the specific violations which the practitioner has committed, both prior and subsequent to the commissioner's warning, and shall make a recommendation as to the specific disciplinary action to be taken against the practitioner. The entire proceeding shall be governed by the procedure for contested case proceedings as provided in Minn. Stat. §§ 15.0411-15.0426 and in 9 MCAR §§ 2.201-2.299.

5. Voluntary suspension. An attorney, accountant, agent, or preparer, in order to avoid the commencement or conclusion of a disciplinary proceeding, may, by agreement with the Commissioner of Revenue, consent to suspension from practice before the Department of Revenue. The Commissioner of Revenue shall then suspend the practitioner in accordance with the disciplinary guideline set forth in 6.

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6. Disciplinary guideline for violation of rule. Upon completion of the hearing in a contested case proceeding for disciplinary action brought by the Commissioner of Revenue against an attorney, accountant, agent, or preparer, if the hearing examiner finds that the practitioner has committed the violations specified in the commissioner's Notice of and Order for Hearing, and that disciplinary action is appropriate, the commissioner shall:

a. Suspend the practitioner from practicing before the Department of Revenue for a period of up to one year, if the proceeding brought against the practitioner is the first proceeding in which disciplinable misconduct has been found;

b. Suspend the practitioner for a period of up to five years if the proceeding brought against the practitioner is the second proceeding in which the disciplinable misconduct has been found; or

c. Disbar the practitioner from practicing before the Department of Revenue if the proceeding brought against the practitioner is at least the third proceeding in which disciplinable misconduct has been found.

For purposes of a., b., and c., a voluntary suspension pursuant to 5. is a proceeding in which disciplinable misconduct has been found. The commissioner shall base his decision as to disciplinary action on all the facts before him, along with any extenuating circumstances he deems relevant.

7. Effect of disbarment or suspension. If the commissioner's order against an attorney, accountant, agent, or preparer is for disbarment, the practitioner shall not thereafter be permitted to practice before the Department of Revenue, except to represent himself. Similarly, if the commissioner's order against an attorney, accountant, agent, or preparer is for suspension, the practitioner shall not thereafter be permitted to practice before the Department of Revenue during the period of suspension, except to represent himself. The disbarment or suspension of an individual, where the individual was employed by a firm or organization at the time his violation of this rule occurred, shall not affect the right of other members of the firm or organization to practice before the department.

8. Petition for reinstatement. If there has been a material change in circumstances after suspension or disbarment, a suspended or disbarred attorney, accountant, agent, or preparer may petition, in writing, the Commissioner of Revenue for reinstatement to practice before the Department of Revenue. The petition must be supported with documentation or testimony from a responsible third party as to the fitness, character and ability of the practitioner to resume practice. The commissioner shall review the petition and make his determination within 30 days as to whether the practitioner shall be reinstated. If the petition is granted by the commissioner, the practitioner may resume practice. If the petition is denied by the commissioner, no further petitions may be brought by the practitioner during the remainder of the suspension period, or for a period of five years if the practitioner has been disbarred.

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13 MCAR § 1.6102 Incorporation by reference of the Internal Revenue Code. *(effective date 1/26/82)* An incorporation by reference of the Internal Revenue Code in Minn. Stat. ch. 290 or 290A shall be interpreted in accordance with any regulations or rulings adopted or issued by the Internal Revenue Service which govern the referenced provisions.

13 MCAR § 1.6225 Targeting. *(Effective date 6/30/81)*

A. Homestead qualifications. The refund contained in Minn. Stat. § 290A.04, subd. 2c (targeting) provides up to $300 of property tax relief in 1981 to homeowners whose property taxes have increased by more than 10% from 1980 after reduction is made for improvements and other state paid credits. To qualify for targeting the property must qualify as the claimant's homestead for purposes of claiming the property tax refund for property taxes payable in 1980 and 1981. The claimant, therefore, must have owned and occupied the property as the claimant's homestead on January 2, 1980 and on January 2, 1981. When a homestead is owned by two or more persons as joint tenants or tenants in common, the tenants shall determine between them which tenant shall be the claimant for purposes of claiming the property tax refund and targeting. The joint tenant or tenant in common who claims the property tax refund in 1981 is the only joint owner who qualifies to claim targeting in 1981. The joint owner who claims the property tax refund and targeting in 1981 need not be the same joint owner who claimed the property tax refund in 1980. In order for a joint owner to claim the property tax refund and targeting in 1981, the property must also have been the joint owner's homestead on January 2, 1980.

B. New construction. The claimant shall reduce the amount of the net property taxes payable in 1981 by the amount which is attributable to improvements. The amount attributable to improvements shall be determined by applying a ratio to the property taxes payable after reduction for the state-paid homestead credit and all other state-paid credits including the property tax refund. The ratio that shall be used is:

$$\frac{\text{Accessor's estimated market value of improvements}}{\text{Assessor's estimated market value of the entire homestead (including land)}}$$

This ratio shall apply to the estimated market value of all improvements which are included in the estimated market value for the first time for property taxes payable in 1981 regardless of the year the improvement was actually made.

C. Net property taxes payable.

1. A claimant who was required to reduce the property taxes payable for purposes of the property tax refund because

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a. the homestead was used for business purposes and depreciation expenses were claimed or,

b. part of the homestead was rented to another, must make the similar reduction in the net property taxes payable which qualify for targeting. The same percentage reduction must be applied to net property taxes payable in 1980 and 1981. The largest percentage reduction must be used whether it be the 1980 percentage reduction or the 1981 percentage reduction.

The taxpayer shall recompute the property tax refund claimed for the year in which the smaller percentage reduction was made. The taxpayer shall use the property taxes for that year reduced by the largest percentage reduction when recomputing the property tax refund.

2. The net property tax payable is only for that part of the property that qualifies as the claimant's homestead. On a duplex, only the property taxes attributable to the homestead portion qualify for targeting.

3. For purposes of computing the net property taxes payable that qualify for targeting, the property taxes payable must be reduced by the amount of the Class 3CC credit which was received under the provisions of Minnesota Statutes, § 273.13, subd. 7.

4. The net property taxes payable in 1980 shall be reduced only by the amount of the property tax refund attributable to property taxes payable. No reduction shall be allowed for that part of a property tax refund attributable to rent constituting property taxes. If a taxpayer's property tax refund includes property taxes payable and rent constituting property taxes, the property tax refund shall be recomputed using only property taxes payable.

D. The taxpayer who must make a reduction for improvements and a reduction for business or rental use must first make the reduction for improvements and then make the reduction for business or rental use. If the improvement that was made is totally used for business or rental use, and this is the only part of the residence that is used for business or rental use, the claimant is required to only make the reduction for the improvement.

13 MCAR § 1.6301 Filing and payment of withheld tax. *(effective date 2/23/82)* For purposes of determining the timeliness of withholding tax payments, returns, or deposits under Minn. Stat. § 290.92, subd. 6, clause (1), the payment, return, or deposit shall be treated as having been made on the earlier of the following dates:

A. The date actually received by the Department of Revenue; or

B. The date of mailing, but only if the payment, return, or deposit was mailed on or before the day prior to the due date, including any extension of time granted for making the payment, return, or deposit. The person required to make the payment, return, or deposit shall have the burden of establishing that the payment, return, or deposit was timely mailed in the United States by United States mail in an envelope or other appropriate wrapper, postage prepaid, and properly addressed.

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