

# Tax Expenditure Evaluation:

## Heating Fuel and Utility Service Exemptions

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PREPARED FOR THE TAX EXPENDITURE REVIEW COMMISSION

DECEMBER 10, 2025

# Heating Fuel and Utility Service Exemptions Include:

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- Residential Heating Fuels (November – April)
- Residential Water Services
- Sewer Services

# Agenda

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- Tax Expenditure Objective
- Background
- Evaluation Findings
- Nine Components of Review

# Tax Expenditure Objective

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The three sales and use tax exemptions share the same objective statement

**“The objective of the Heating Fuel and Utility Service tax exemptions is to lessen the effective tax burden of lower-income households and reduce the regressivity of the sales and use tax.”**

The shared objective was approved and adopted by the Tax Expenditure Review Commission on August 16, 2024

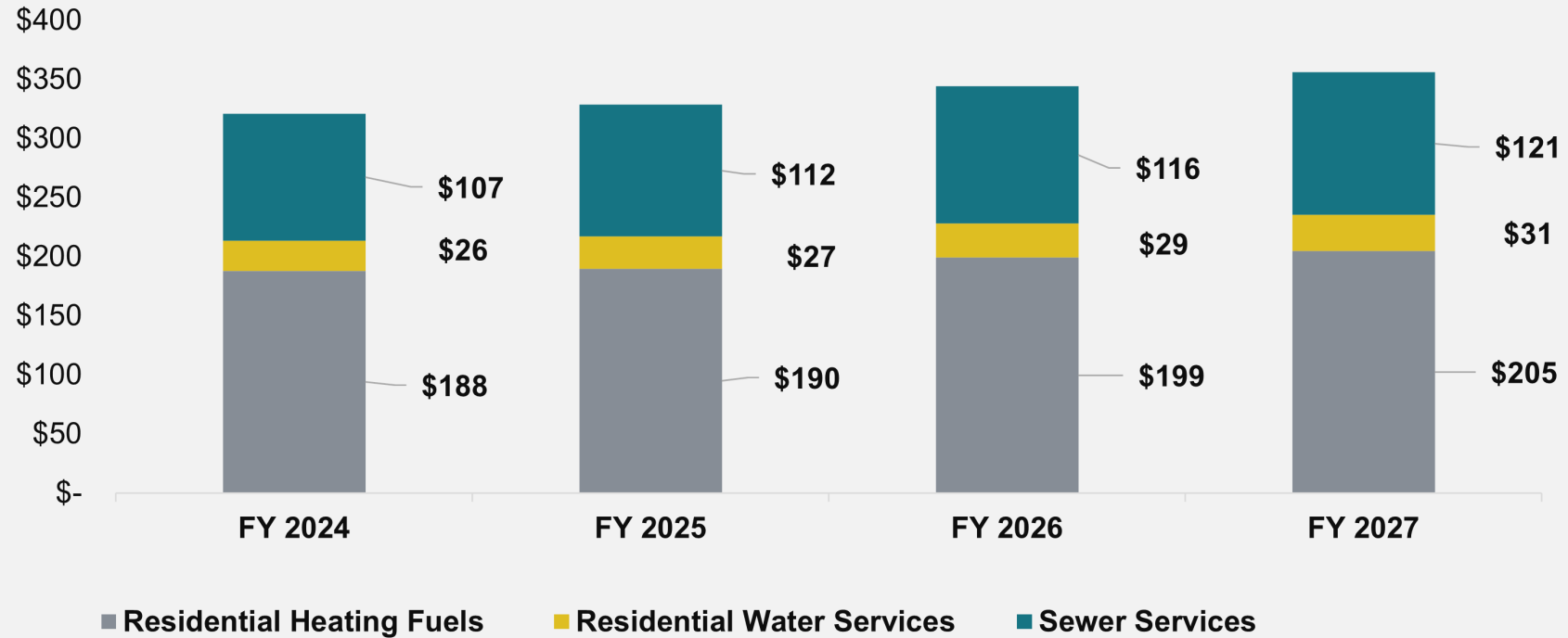
# Background

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- Residential Heating Fuels enacted in 1978; expanded in 1984 to include hot water
- Residential Water Services enacted in 1979
- Sewer Services have never been subject to the sales and use tax
- Applies to all MN households regardless of volume, location, household income, etc.

# Estimated Fiscal Impact

Fiscal Impact of Residential Heating Fuels, Residential Water Services, and Sewer Services,  
Fiscal Years 2024 – 2027 (in millions)



Source: 2024 Department of Revenue Tax Expenditure Budget

# Evaluation Findings

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- Regressivity of the sales and use tax is reduced
- Suits Index for state and local sales tax = **-0.221** (*2024 DOR Incidence Study*)
- If these tax expenditures were repealed individually or cumulatively:

Tax Expenditure Hypothetically Repealed	Suits Index
Residential Heating Fuels	-0.232
Residential Water Services	-0.227
Sewer Services	-0.227
All Three Utility Tax Expenditures	-0.234

Source: Department of Revenue Tax Research Division

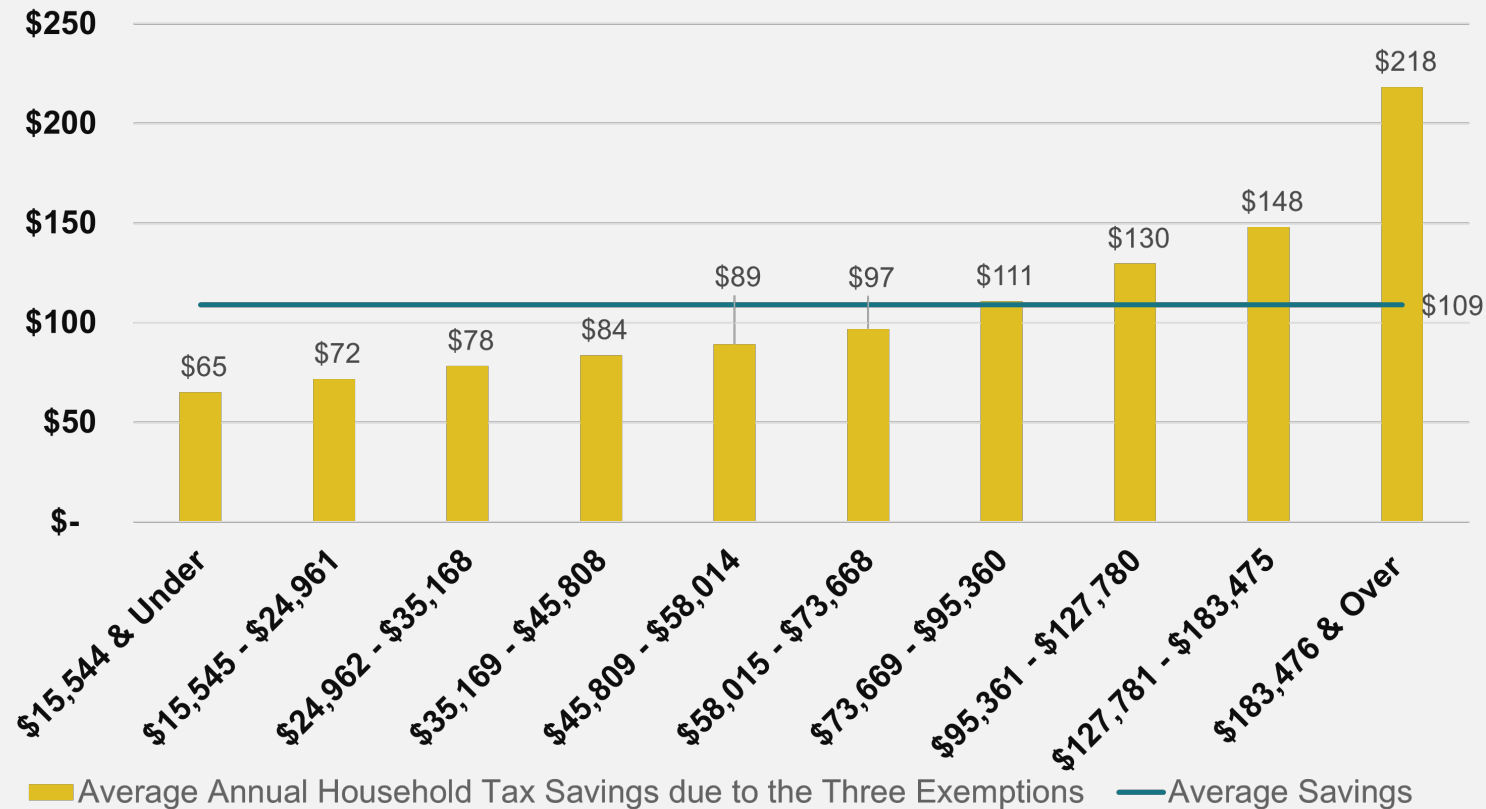
# Change in Tax Burden

Population Decile	Household Income	Change in Tax Burden
First	\$15,544 & Under	0.63%
Second	\$15,545 - \$24,961	0.36%
Third	\$24,962 - \$35,168	0.26%
Fourth	\$35,169 - \$45,808	0.21%
Fifth	\$45,809 - \$58,014	0.17%
Sixth	\$58,015 - \$73,668	0.15%
Seventh	\$73,669 - \$95,360	0.13%
Eighth	\$95,361 - \$127,780	0.12%
Ninth	\$127,781 - \$183,475	0.10%
Tenth	\$183,476 & Over	0.05%

Note: Each Population Decile contains 293,739 households  
Source: Department of Revenue Tax Research Division



# Households Tax Savings by Population Deciles



Note: Tax savings estimates for 2024, based on the effective sales tax rate of 2021

Source: Department of Revenue Tax Research Division

# Evaluation Findings – continued

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- As a proportion of income, lower income deciles receive a reduction in tax burden that is marginally higher than higher income deciles
- \$109 average household tax savings in 2024
- Higher-income households receive more monetary benefit than lower-income households, AND a larger percentage of the change in tax share
  - 1<sup>st</sup> - 3<sup>rd</sup> population deciles received roughly \$72 in FY 24 in tax savings due to these exemptions
  - 8<sup>th</sup> – 10<sup>th</sup> population deciles received roughly \$165 in FY 24 in tax savings due to these exemptions

# Component of Review #1:

## Estimate of Annual Revenue Lost

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<b>Fiscal Year:</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>
<b>Residential Heating Fuels</b>	\$187,900,000	\$189,700,000	\$199,100,000	\$204,600,000
<b>Residential Water Services</b>	\$25,500,000	\$27,200,000	\$28,900,000	\$30,700,000
<b>Sewer Services</b>	\$107,300,000	\$111,600,000	\$116,100,000	\$120,800,000

Source: Department of Revenue 2024 Tax Expenditure Budget

## Component of Review #2: Objective of the Tax Expenditure

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The objective of the Heating Fuel and Utility Service tax exemptions is to **lessen the effective tax burden of lower-income households** and **reduce the regressivity of the sales and use tax.**

This objective was approved and adopted by the Tax Expenditure Review Commission on August 16, 2024

# Component of Review #3:

## Impacts and Efficiency in Accomplishing Objective

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Residential Water, Residential Heating, and Sewer Services Impact:

- Over 2.35 million households impacted
- \$109 average annual tax savings benefit
- No benefit cap for households
- Targeted good or service consumed by beneficiaries
- No administrative burden to beneficiaries

# Component of Review #4:

## Compare to Direct Expenditure with the Same Objective

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Minnesota Family Investment Program (MFIP) – Cash Assistance Portion

- Limited by federal and state funding
- Requirements include: income limits, work requirements, and state residency
- \$545 average cash assistance payment in September 2025
- 21,276 families participated in cash-assistance in September 2025

# Component of Review #5:

## Potential Modifications to Increase Efficiency or Effectiveness

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Alternative:

Utility usage is tax-exempt up to a certain threshold amount.

Example:

State of Maine exempts up to 750 kilowatt-hour per month of electricity purchased for residential use.

# Component of Review #6:

## Revenue Neutral Tax Rate Reduction

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Sales and Use Tax Exemption:	Current Sales and Use Tax Rate:	Revenue-Neutral Tax Rate	Percentage Point Decrease
Residential Heating Fuels	6.875%	6.726%	0.145
Residential Water Services	6.875%	6.854%	0.025
Sewer Services	6.875%	6.789%	0.085

Source: Department of Revenue 2024 Tax Expenditure Budget



# Component of Review #7: Incidence of the Tax Expenditures and Effect on the State Tax System

Resident by Population Decile:	Sales and Use Tax:	Cumulative Tax Change:	Cumulative Share of Tax Change:	Combine Average Annual Household Tax Savings:
<b>\$15,544 &amp; Under</b>	\$275,989,456	\$19,134,697	6.0%	\$65.14
<b>\$15,545 - \$24,961</b>	\$321,365,571	\$21,091,126	6.6%	\$71.80
<b>\$24,962 - \$35,168</b>	\$369,752,647	\$22,993,551	7.2%	\$78.28
<b>\$35,169 - \$45,808</b>	\$417,394,917	\$24,583,668	7.7%	\$83.69
<b>\$45,809 - \$58,014</b>	\$465,046,347	\$26,189,633	8.2%	\$89.16
<b>\$58,015 - \$73,668</b>	\$526,644,412	\$28,464,402	8.9%	\$96.90
<b>\$73,669 - \$95,360</b>	\$641,957,246	\$32,543,613	10.2%	\$110.79
<b>\$95,361 - \$127,780</b>	\$802,412,748	\$35,782,451	11.2%	\$129.64
<b>\$127,781 - \$183,475</b>	\$988,123,559	\$43,489,878	13.7%	\$148.05
<b>\$183,476 &amp; Over</b>	\$2,041,065,136	\$64,131,400	20.1%	\$218.33
<b>Non-Residents</b>	\$1,605,124,031	\$0	0.0%	
<b>All</b>	\$8,454,876,070	\$318,404,419	100.0%	\$109.00

Note: Each population decile contains 293,739 households. Source: Department of Revenue Tax Research Division

# Component of Review #7 - continued

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- Regressivity of the sales and use tax is reduced
- Repeal would increase regressivity from -0.221 to -0.232 on the Suits Index
- Tax burden of lower-income deciles is reduced marginally more than higher-income deciles as a proportion of income

# Component of Review #8:

## Cumulative Fiscal Impacts of Other State and Federal Policies

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- Federally funded programs:
  - Energy Assistance Program (EAP)
  - Weatherization Assistance Program
  - Low-income Households Water Assistance Program (LIHWAP)
- Federal and State-funded program:
  - Minnesota Family Investment Program (MFIP)
- State and private programs:
  - “Cold Weather Rule” (protection from service shut off due to non-payment) (Oct 1<sup>st</sup> – Apr 30<sup>th</sup>)
  - “Extreme Heat Law” (protection from service shut off when an excessive heat advisory is issued)
  - Assistance programs offered by Utility providers operating in the state (*Xcel Energy* senior discount program / *Minnesota Power* income-based assistance program)

# Component of Review #8 continued:

## Cumulative Fiscal Impacts of Other State and Federal Policies

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Alternative Direct Expenditure Programs	Program Expenditures	Number Households Impacted	Data Year
EAP	\$95,922,054	129,837	*FFY 2024
MFIP	***\$313,191,770	66,671	**FY 2023
LIHWAP	\$6,169,353	11,550	FY 2022
Weatherization Assistance Program	\$16,145,162	4,122	FY 2022

\*FFY represents a federal fiscal year spanning October 1 to September 30

\*\*FY represents a state fiscal year spanning July 1 to June 30

\*\*\*Expenditure estimate includes TANF expenditures of \$90,606,466; State of Minnesota General Fund expenditures of \$67,793,199; and Supplemental Nutrition Assistance Program expenditures of \$154,792,105

# Component of Review #9:

## Recommendation to the Legislature

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The Commission may choose to consider these findings in preparing a recommendation to the legislature to continue, repeal, or modify the tax expenditure, as is required of the Commission under Minnesota Statutes 2024, section 3.8855, subdivision 5.

# Thank you

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# Appendix

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# Appendix: What are other states doing?

Essential Service:	Number of states that pay tax on this service:	Neighboring States (North Dakota, South Dakota, Iowa, and Wisconsin):
Residential Heating Fuels	22	All Neighboring States do not pay tax on this service
Electricity	22*	South Dakota and Wisconsin pay tax on this service
Natural Gas	21	South Dakota and Wisconsin pay tax on this service
Water and Sewer	13**	North Dakota pays tax on these services

Note: There is no sales tax in Alaska, Delaware, Montana, New Hampshire, and Oregon

\*Some states exempt electricity with certain exceptions. These are not included in this count.

\*\* Includes Washington D.C.

Source: Bloomberg Tax Research, Sales and Use Tax Chart Builder



# Appendix: State of Maine Tax Exemption Limit Statute

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Title 36, Part 3, Chapter 211, Section 1760 Exemptions:

9-B. Residential electricity. Sale and delivery of residential electricity as follows:

- A. The first 750 kilowatt hours of residential electricity per month;
- B. Off-peak residential electricity used for space heating or water heating by means of an electric thermal storage device. For the purpose of this paragraph, "off-peak residential electricity" means the off-peak delivery of residential electricity pursuant to tariffs on file with the Public Utilities Commission and the electricity supplied; and
- C. Residential electricity consumed by eligible customers enrolled in a low-income assistance program implemented pursuant to Title 35-A, section 3214, subsection 2 or an arrearage management program implemented pursuant to Title 35-A, section 3214, subsection 2-A.

# Appendix: Best Practices to Evaluate Tax Expenditures

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At minimum, evaluations should include:

- A description of the incentive, including its history and goals
- An assessment of the program's design and administration
- Estimates of the expenditure's economic and fiscal impacts
- Policy recommendations

*Best Practices presented to TERC August 11, 2022, by PEW Charitable Trusts*

# Appendix: General Tax Principles

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I. Allocative Efficiency (Neutrality)

II. Fairness and Equity

- Horizontal Equity – Equal treatment of equals

III. Simplicity

- Transparency
- Ease of compliance and administration

May conflict with each other or with policy goals (vertical equity, maintaining state competitiveness, promoting economic development)