

**Federal Update
American Rescue Plan Act**

	FY 2022	FY 2023	FY 2024	FY 2025
		(\$000s)		
Individual Income Tax	(\$267,600)	(\$400)	(\$800)	(\$400)
Corporate Franchise Tax	<u>\$21,700</u>	<u>(\$500)</u>	<u>(\$700)</u>	<u>(\$300)</u>
General Fund Total*	(\$245,900)	(\$900)	(\$1,500)	(\$700)

*Totals do not include the impact of the worldwide interest allocation repeal, which is still being estimated.

The American Rescue Plan Act (Public Law 117-2) was enacted on March 11, 2021. The proposal is to update reference to the Internal Revenue Code to include the Act. The Act includes the following provisions which would affect the definition of income for Minnesota individual income tax or corporate franchise tax purposes.

Unemployment Exclusion. For tax year 2020 only, an individual taxpayer with adjusted gross income less than \$150,000 may exclude from adjusted gross income an amount equal to the taxpayer's regular and supplemental unemployment compensation up to \$10,200. For a joint return, the exclusion is limited to \$10,200 in unemployment compensation received by each spouse.

Dependent Care Credit. The Act increases the maximum expenses that can be claimed for the federal dependent care credit from \$3,000 (\$6,000 for two or more dependents) to \$8,000 (\$16,000 for two or more dependents.) Under prior federal law, the maximum credit rate was 35% and decreased with income to a minimum of 20%. The Act increases the maximum credit to 50%. The credit rate is reduced with income and is phased out completely at adjusted gross income of \$440,000 or more. The credit is also now refundable.

The Minnesota dependent care credit is a refundable credit that is equal to the federal credit but phased out for taxpayers with adjusted gross income over a threshold (\$53,630 in tax year 2021). Adopting the federal provisions would increase the Minnesota credit.

Dependent Care Assistance. For tax year 2021 only, the Act increases the maximum exclusion for dependent care benefits from \$5,000 to \$10,500 (\$5,250 for married separate filers).

Discharged Student Loans. In general, forgiven debt is included in taxable income. The Act excludes from income certain discharged student loan debt, including governmental education loans, private education loans, and certain loans made by charitable organizations designed to encourage students to fill occupations with unmet needs. The exclusion is effective for tax years 2021 through 2025.

Excess Business Losses. The Tax Cuts and Jobs Act established limits on pass-through losses for tax years 2018 through 2025, limiting deductions for losses from a partnership, S corporation, or sole proprietorship to \$250,000 (\$500,000 for married joint filers). Any excess losses over that amount were to be carried over to following tax years. The CARES Act retroactively removed the limit for excess business losses in tax year 2018, 2019, and 2020, keeping the limitation in effect for tax year 2021 through 2025. The Rescue Plan Act extends the limitation one year through tax year 2026. The provision will increase revenue outside the forecast window.

Extend Credits for Paid Sick and Family Leave. The Families First Coronavirus Response Act created tax credits for employers who provide paid sick leave and paid family and medical leave, and similar tax credits for self-employed individuals who would qualify for paid leave if they were employees. The federal credits are equal to 100% of the eligible expenses for providing leave, with certain limits. Federal law requires the credits to be included in gross income. The Consolidated Appropriations Act 2021 extended the credits through March 31, 2021. The Rescue Plan Act extends the credits through September 30, 2021. The provision will result in an increase in taxable income for some employers.

Extend Employee Retention Credit. The CARES Act created a refundable payroll tax credit to help qualifying employers cover payroll costs. Qualifying employers can claim a tax credit of up to \$5,000 per employee. Under federal law, the credit is not included in gross income and any expenses paid with the credit are not deductible. The Consolidated Appropriations Act 2021 extended the credit for wages paid through June 30, 2021. The Rescue Plan Act extends the credit through December 31, 2021. The provision will result in an increase in taxable income for some employers.

Credit for Health Insurance Premium Assistance. The Act establishes a tax credit for employers to cover the cost of COBRA health insurance coverage for terminated employees. The amount of the credit must be included in the employer's gross income.

Targeted Economic Injury Disaster Loan Advances. The Act allocates \$15 billion in fiscal year 2021 to be used for targeted EIDL Advances, of which \$10 billion is used to cover eligible businesses who applied for the previous EIDL Advance but could not claim the full amount because of a lack of available funding. The remaining \$5 billion is to be used to for new targeted EIDL advances. These new targeted advances are for businesses who have suffered at least a 50% loss in revenue and who do not employ more than 10 people. The maximum targeted advance is \$5,000 per business. Advances do not have to be repaid and are not included in gross income. Allowing the exclusion will decrease gross income, reducing revenue.

Restaurant Revitalization Fund. The Act allocates \$28.6 billion in fiscal year 2021 to be used as grants for restaurants to help cover their eligible expenses. These expenses include payroll, rent, utilities, and supplies necessary for the operation of a restaurant. The grants are equal to the amount of revenue a business has loss during the COVID pandemic. The maximum grant a business may receive is \$10 million, but each physical location is limited to \$5 million. These grants are not included in gross income. Allowing the exclusion will decrease gross income, reducing revenue.

Worldwide Interest Allocation Rules. The Act repealed a provision that would have allowed U.S. firms to allocate interest expenses worldwide for the purposes of calculating the foreign tax credit beginning with tax year 2021. The impact of this provision is still unknown.

Deny Deduction for Executive Compensation. Under prior federal law, a publicly held corporation could not deduct compensation over \$1 million for the CEO, CFO, and the next three highest paid employees. The Act extends that provision to include the next eight highest paid employees beginning in tax year 2027. The provision will limit deductions for some corporations, potentially increasing taxable income outside the forecast window.

- The estimates for most provisions are based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated March 9, 2021.
- Where applicable, the estimates were divided between the individual income tax and corporate franchise tax. The estimates for each provision were apportioned to Minnesota based on information relevant to that provision. The estimates were adjusted for the difference between federal and state tax rates and federal and state fiscal years.

Unemployment Exclusion

- About 821,300 individuals received \$9.68 billion in unemployment insurance payments in 2020, according to information provided by the Department of Employment and Economic Development.
- It was assumed that around 65% of claims would result in taxable income on individual returns, based on the average percentage of claims that were reported as taxable income.
- Exclusion in tax year 2020 are expected to total \$3.612 billion with the \$10,200 maximum and the \$150,000 income limit, based on unemployment insurance reported on 2018 returns, adjusted to reflect payments in 2020.
- A marginal rate of 6.5% was assumed.
- Retroactive impacts were allocated to fiscal year 2022.

Dependent Care Credit

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in November 2020. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year 2021 impact was allocated to fiscal year 2022.

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Tax Research Division
April 13, 2021

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American Rescue Plan Act of 2021
(\$000s)**

	FY 2022	FY 2023	FY 2024	FY 2025
Unemployment exclusion up to \$10,200 per recipient for returns with less than \$150,000 adjusted gross income (TY20 only)				
Individual Income Tax	(\$234,800)	\$0	\$0	\$0
Increase dependent care credit (TY21 only)				
Individual Income Tax	(\$35,000)	\$0	\$0	\$0
Increase exclusion for employer-provided dependent care assistance (TY21 only)				
Individual Income Tax	(\$800)	\$0	\$0	\$0
Exclusion for certain forgiven student loans (TY21-TY25)				
Individual Income Tax	(\$100)	(\$100)	(\$100)	(\$100)
Extend limitation on excess business losses of noncorporate taxpayers (TY26 only)*				
Individual Income Tax	\$0	\$0	\$0	\$0
Extend credits for paid sick and family leave (TY21 only)				
Individual Income Tax	\$1,300	\$0	\$0	\$0
Corporate Franchise Tax	\$3,800	\$0	\$0	\$0
Extend employee retention credit (TY21 only)				
Individual Income Tax	\$1,000	\$0	\$0	\$0
Corporate Franchise Tax	\$2,900	\$0	\$0	\$0
Credit for health insurance premium assistance (TY21 only)				
Individual Income Tax	\$7,500	\$0	\$0	\$0
Corporate Franchise Tax	\$21,400	\$0	\$0	\$0
Exclusion of economic injury disaster loan advances (TY21 only)				
Individual Income Tax	(\$2,500)	(\$100)	(\$300)	(\$100)
Corporate Franchise Tax	(\$2,400)	(\$200)	(\$300)	(\$100)
Exclusion of restaurant revitalization grants (TY21 only)				
Individual Income Tax	(\$4,200)	(\$200)	(\$400)	(\$200)
Corporate Franchise Tax	(\$4,000)	(\$300)	(\$400)	(\$200)
Repeal worldwide interest allocation rules (beginning TY21)				
Corporate Franchise Tax	Unknown	Unknown	Unknown	Unknown
Deny deduction for certain highly compensated executives (beginning TY27)*				
Corporate Franchise Tax	\$0	\$0	\$0	\$0
All Provisions				
Individual Income Tax	(\$267,600)	(\$400)	(\$800)	(\$400)
Corporate Franchise Tax	\$21,700	(\$500)	(\$700)	(\$300)
General Fund Total	(\$245,900)	(\$900)	(\$1,500)	(\$700)

*Revenue impact occurs outside of the forecast window.